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ELECTRIC UTILITY MERGERS: UNCERTAINTY LOOMS OVER REGULATORY APPROVALS AT THE FERC

John S. Moot

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ELECTRIC UTILITY MERGERS: UNCERTAINTY LOOMS OVER REGULATORY APPROVALS AT THE FERC

John S. Moot *

I. INTRODUCTION

At long last, social Darwinism seems to have arrived at the doorstep of the once staid world of regulated electric utilities. Deregulation, open access, hostile takeovers, poison pills, and white knights now rule the previously tranquil world of the regulated monopoly dinosaur. But today, as utilities warily eye one another in their strategic consideration of whether to acquire or be acquired, perhaps the single greatest truism is uncertainty. Utilities seeking partners to compete better in this brave new world must approach their regulatory overseer with trepidation.

Quickly fading is the notion that a merging couple need only offer transmission access to slip through a Federal Energy Regulatory Commission (FERC or Commission) proceeding unscathed.¹ In the proposed merger of

* B.A., 1983, St. Lawrence University; J.D., 1988, American University. Member, Maryland and District of Columbia Bars; associate, Verner, Liipfert, Bernhard, McPherson and Hand. Mr. Moot served as counsel to the City of Pasadena in *Southern California Edison Co.*, and as counsel to the State of New Hampshire and the New Hampshire Public Utilities Commission in *Northeast Utilities Service Co.*

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1. This was openly pursued, in *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097 (1990). [It should be] clear to all future applicants that they cannot 'sweeten the pie' with transmission in order to avoid a hearing on a merger. Any suggestion, past or future, that voluntary transmission

Southern California Edison Company (Edison) and San Diego Gas & Electric Company (SDG&E),² there were calls to divest Mission Energy Company, SCEcorp's unregulated³ profit center. In the proposed merger of Northeast Utilities Service Company (NU) and Public Service Company of New Hampshire (PSNH),⁴ NU was hit with proposals to divest its transmission and generation assets, strip its native load customers from priority use of the transmission system, and disenfranchise it within the New England Power Pool (NEPOOL).

The unpredictability of this journey has been remarkable. In *Southern California Edison Co.*, the company was backed by the FERC staff and the Department of Justice on most major competitive issues, but the administrative law judge slammed the merger-approval door and denied the merger application outright.⁵ Across the hall in *Northeast Utilities Service Co.*, the FERC staff staked out an aggressive position, arguing for tough conditions, but was largely rebuffed by the judge, who sided with the company on most major issues relating to the form of wheeling ordered.⁶ In both cases, reliance on the Commission's "unprecedented" decision in *Utah Power & Light Co.*⁷ was sparse. Were these judges marching to the same drummer?

Not even traditional alliances were safe in these proceedings. While, as expected, the applicants in each case squared off against their traditional public power competitors,⁸ the merger partners were faced with surprising opposition from their brethren, investor-owned utilities (IOUs). Competitor IOUs teamed up with other intervenors, including well-financed qualifying facilities (QFs) and independent power producer groups, to oppose unconditional merger approval.⁹

Is all this uncertainty a temporal illusion? Will the FERC step in and enunciate with clarity what it demands from future merger partners, its judges and staff, and intervening parties? The industry's ability to gauge the propriety of future ventures hangs in the balance. Utility litigation managers and

conditions are a ticket to summary approval based on a wink or nod at the Commission will, I hope, have been dashed by this order.

Id. at 61,297 (Trabandt, Comm'r, concurring).

2. Southern Cal. Edison Co., 53 F.E.R.C. ¶ 63,014 (1990).

3. Mission Energy has ownership interests in "qualifying facilities" (QFs) as that term is defined by the Public Utilities Regulatory Policies Act (PURPA), 16 U.S.C. § 796 (1988), and is owned by Edison's parent company, SCEcorp.

4. Northeast Utils. Serv. Co., 53 F.E.R.C. ¶ 63,020 (1990).

5. *Edison*, 53 F.E.R.C. ¶ 63,014 at 65,149.

6. *See Northeast Utils.*, 53 F.E.R.C. ¶ 63,020.

7. Opinion No. 318, 45 F.E.R.C. ¶ 61,095 (1988).

8. "After years of strife between transmission 'haves' and 'have-nots', with only modest change in the ground rules, the stage is set for more fundamental shifts in policy." Marritz, *PG&E's Bold Entry in the Transmission Policy Sweepstakes*, *ELECTRICITY J.*, Dec. 1988, at 26.

9. "What has been particularly startling in recent cases is the extent to which 'friendly' neighboring investor-owned utilities have lined up in regulatory proceedings to 'protect their rights' or 'extract their pound of flesh,' depending on one's point of view." Presentation by Hawes to EEI Legal Committee, *Is Omphaloskepsis Enough in Today's Changing Utility Mergers and Acquisitions Environment?* (Nov. 9, 1990) [hereinafter Hawes].

Commission budgeteers tremble at the thought that the present uncertainty may continue.

Longstanding, fundamental questions need to be answered, such as—should utilities' transmission systems be opened up for use by all competitors;¹⁰ would open access increase competition and promote economic efficiency, or would it strand investment and harm reliability;¹¹ and if access is granted, what price is fair or efficient?¹² And some less often considered, but rather basic questions demand attention—should mergers be encouraged¹³ so as to obtain greater industry-wide economies of scale;¹⁴ do mergers harm competition by consolidating control of scarce transmission capacity; what are the effects of opening up transmission on a case-by-case basis;¹⁵ and does existing antitrust law and policy provide any guidance to the Commission in determining harm to competition in a heavily regulated industry?¹⁶

How will the Commission respond? Only Commissioner Trabandt

10. See FERC TRANSMISSION TASK FORCE, *ELECTRICITY TRANSMISSION: REALITIES, THEORY AND POLICY ALTERNATIVES* (Oct. 1989). Compare Marritz, *PG&E's Bold Entry in the Transmission Policy Sweepstakes*, *ELECTRICITY J.*, Dec. 1988, at 26 (stating that "[i]t is widely understood that competition cannot be free or fair without reasonable provisions for transmission access to buyers and sellers") with Pace, *Wheeling and the Obligation to Serve*, 8 *ENERGY L.J.* 265 (1987) (stating that "[a] customer-access-to-transmission policy would expose utilities to major potential load shifts and thus raise significant obligation to serve problems").

11. Compare Office of Technology Assessment, *Electric Power Wheeling and Dealing: Technological Considerations for Increasing Competition* (1989) (finding no inherent technological barriers to greater wheeling) with Campbell, *Some Practical Questions About Electric Utility Restructuring*, *ELECTRICITY J.*, Dec. 1988, at 12, 15. ("You simply cannot put electric power in at Point A and have it delivered to Point B without evaluating what impact such a transaction will have on reliability of the transmission system hundreds of miles away.")

12. See Wallace, *A Negotiated Alternative to Mandatory Wheeling*, 10 *ENERGY L.J.* 99, 113-18 (1989).

13. See Kansas City Power & Light Co., 53 F.E.R.C. ¶ 61,097, at 61,290 (1990) (Trabandt, Comm'r, concurring).

[The Commission has] not, as a matter of policy, supported broad based consolidation of electric utility companies across the nation such as the 50-company-5-year concept At the same time, we have not opposed the notion of electric utility consolidations or mergers as a matter of general policy on the basis that they would be contrary to the public interest.

Id.

14. "[T]here are too many small utilities that are not achieving economies of scale and coordination." JOSKOW & SCHMALENSEE, *MARKETS FOR POWER: AN ANALYSIS OF ELECTRIC UTILITY DEREGULATION* 219 (1983). "A view held by many within and without the industry [is] that there is an uneconomically large number of entities and that some rationalization is inevitable. Hawes, *supra* note 9, at 30. Or as J.P. Morgan put it: "Why not merge them (small businesses) into a few giant corporations that would avoid price wars and produce efficiently?" Austin, *Antitrust Reaction to the Merger Wave: The Revolution vs. The Counterrevolution*, 66 *N.C.L. REV.* 931, 933 n.16 (1988).

15. "[T]he Commission in *UP&L* took advantage of an opportunity to establish a new process which the FERC can police to promote what they perceive as greater efficiencies in the regional bulk power market." Williams, *Wheeling & Dealing: FERC's Evolving Approach to Electric Utility Mergers*, *ELECTRICITY J.*, Aug.-Sept. 1988, at 16. "[If conditions bearing a reasonable relationship to the merger] happen also to further a policy the regulator espouses, and assuming it does not contravene statutory authority, there would seem to be nothing wrong with such regulatory action." Hawes, *supra* note 9, at 16-17.

16. "[C]oncern for concentration in bulk power supply markets must be balanced against the desirability of exploiting available economies of scale and scope." JOSKOW & SCHMALENSEE, *supra* note 14, at 196.

remains from the Commission that issued *Utah Power & Light*. Gone are Chairman Hesse and Commissioner Stalon,¹⁷ two staunch advocates of greater competition and transmission access. They have been replaced by Chairman Allday and Commissioners Langdon, Moler and Terzic, whose views on these issues remain largely unknown.

It is readily conceded that there are no easy answers to these macro-questions. Putting this limitation to one side, however, there are a dangerous number of important issues that remain unresolved, even unaddressed, and it would be advisable for the FERC to provide some "precedential" guidance to the industry and to its judges. To this end, this article seeks to bring into focus some of the most controversial questions so that the decisionmakers can see the work that lies ahead. This article does not advocate a particular substantive course; instead it urges the Commission to meet such questions head on and to provide some answers.

The article begins by providing a brief historical perspective to help explain the origins of the current controversy. It then lays out applicable anti-trust principles that the Commission may employ as it gauges a merger's effect on the nascent competition emerging in the industry. Thereafter, a capsule of several recent merger proceedings is provided. In the last section, the article breaks out a number of topics that have emerged as leading contenders for resolution by the FERC and provides a look at both sides of the debate.

II. A HISTORICAL PERSPECTIVE: WHY ALL THE FUSS?

If mergers are not new to the industry, and they are not,¹⁸ then why all the fuss? The reason may simply be that "[m]ergers are different, with a special mystique that conjures up imagery of warfare, greed, and skullduggery."¹⁹ Though there may be some truth to this, there are likely several specific reasons for all the recent attention.

First, the recent consolidations have dwarfed previous mergers in size.²⁰ The Utah Power & Light Company (UP&L)/Pacific Power & Light Company (PP&L) consolidation resulted in a utility spanning seven states. The Edison/SDG&E merger will produce, by some measures, the largest electric utility in the nation. The merger of NU and PSNH will create the largest utility in NEPOOL.

Second, the mergers came on the heels of a decade when the rest of corporate America was experiencing frequent, and sometimes massive, mergers and consolidations. But for the most part, the electric utility industry was on the sidelines. There were regulatory hurdles—approvals before state commis-

17. Commissioner Stalon has been referred to as "the architect of the long-term wheeling obligations in the UP&L/PacifiCorp case." Williams, *supra* note 15, at 25.

18. Mergers and acquisitions reduced the number of investor-owned utilities nationally from 2,000 in 1920 to 465 in 1957, and today there are approximately 230. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 6-7.

19. Austin, *supra* note 14, at 956.

20. See Williams, *supra* note 15, at 17 ("Prior to the UP&L/PacifiCorp case, FERC had never confronted a proposed merger involving the corporate and jurisdictional disappearance of an electric utility anywhere as large as UP&L.").

sions, the Securities Exchange Commission (SEC), and the FERC.²¹ There were questions as to whether merger “benefits” would accrue to shareholders or instead be flowed through to ratepayers. In some senses, too, there was simply no need—until the 1970s, utilities had experienced increasing load growth, rate base, and profits.²² With slow growth, high inflation, and prudence disallowances in the 1970s and 1980s placing crippling pressures on the “regulatory compact,”²³ maybe it was the electric utility industry’s turn to choose consolidation to enhance shareholder value and obtain efficiencies.²⁴

Third, the mergers occurred in the midst of a growing debate regarding the future of competition (and regulation) in the industry.²⁵ While other industries had been deregulated in the late 1970s and early 1980s,²⁶ it was safe to say that “[t]he electric power industry represents one of the last bastions of pervasive government regulation of prices, entry, and industry structure in the economy.”²⁷ In the early 1980s, many economists suggested that certain portions of the industry could be deregulated, particularly bulk power.²⁸ Congress enacted PURPA in 1978 to facilitate the growth of an independent generation sector. Greater transmission access was called for by many to

21. See Hawes, *supra* note 9, at 9 (noting “formidable regulatory obstacles such as the requirements for state regulatory commissions, FERC, NRC, and SEC approval”).

22. Cf. Stalon & Lock, *State-Federal Relations in the Economic Regulation of Energy*, 7 YALE J. ON REG. 427, 445 (1990) (“The combination of declining real production costs, the strong monopoly power of vertically integrated utilities, and a stable economic environment where input prices and final demand remained constant for long periods of time, all provided the necessary conditions for this regulatory system to work effectively.”).

23. See *id.* at 432.

Economic forces dramatically reduced the rate of demand growth for electricity and increased the real costs and risks associated with building new generation capacity. The traditional regulatory system proved incapable of efficiently adapting its ratemaking model to use existing capacity efficiently and to create an efficient risk/reward symmetry for generation expansions in this new economic environment. The result was over-expansion of generating capacity in the face of declining demand, large and increasingly contested rate increase requests, disallowed recovery of utility capital expenditures, and a consequent aversion by utilities to major new capital expenses.

Id.

24. Another explanation could be the “epaulet problem, *viz.*, there is generally only one CEO, CFO, General Counsel, etc. and the incumbents (utility officers) are reluctant to give up those positions.” Hawes, *supra* note 9, at 31.

25. See generally BREYER, *REGULATION AND ITS REFORM* (1982). For a study of the factors that contributed to the success of the deregulation movement, see DERTHICK & QUIRK, *THE POLITICS OF DEREGULATION* (1985).

26. The Carter Administration declared that it would strive “to reduce, rationalize and to streamline the regulatory burden throughout American life.” N.Y. Times, Mar. 26, 1979, at 1, col. 1.

27. JOSKOW & SCHMALENSEE, *supra* note 14, at 211.

28. JOSKOW & SCHMALENSEE, *supra* note 14; Pace & Langdon, *Introducing Competition into the Electric Utility Industry: An Economic Appraisal*, 3 ENERGY L.J. 1 (1982); Cohen, *Efficiency and Competition in the Electric Power Industry*, 88 YALE L.J. 1511 (1979); Lock, *Models for Bulk Power Deregulation: What Promise for the Future*, 38 ADMIN. L. REV. 349 (1986). More recently, it has been said that “[c]ompetition in wholesale power markets, or at least between franchised utilities, seems to be widely supported.” Stalon & Lock, *supra* note 22, at 471. Some, however, have cautioned that the decisionmakers “not overlook the possibility that competitive pressures could actually decrease as a result of deregulation, as appears to have occurred in the airline industry.” Campbell, *supra* note 11, at 12. For a more recent exposition on the issue, see Hughes & Hall, *Substituting Competition for Regulation*, 11 ENERGY L.J. 243 (1990).

ensure that these independent power generators could compete on an equal footing with utility generation.²⁹

Finally, the mergers occurred in the midst of a "revolution" in merger enforcement by the federal government.³⁰ The Reagan Administration significantly curtailed challenges to mergers as compared to previous administrations.³¹ The Administration's philosophy represented the view of many antitrust academics and commentators (the "Chicago School")³² who were critical of the antitrust precedents and enforcement policies of the 1960s and 1970s. These policies, they said, were borne of a "big is bad" mentality that failed to focus sufficiently on economic efficiency and consumer welfare as the ultimate objective of antitrust. The Warren Court merger decisions were described as a "metamorphosis of economics, populism and opaque value judgments" that laid an "impenetrable minefield of precedent" for the Government to use in condemning virtually any merger.³³ Which school of thought would the FERC lean toward in applying the antitrust laws to electric utility mergers?

These undercurrents help to provide a backdrop to the current debate over how the FERC should evaluate the competitive effects of an electric utility merger. The themes will pop up again and again in the pages that follow.

III. A MERGER'S EFFECT ON COMPETITION: BORROWING ANTITRUST PRINCIPLES

As competition has become a buzzword in the industry, it is not surpris-

29. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 77; *see also* JOSKOW & SCHMALENSSEE, *supra* note 14, at 195 ("Some form of guaranteed access to transmission facilities and associated coordination facilities seem essential for any of the deregulation scenarios to work well.") "The open access efforts of [nonutility generators]— many of them large firms in their own right—have lent new force to longstanding open-access efforts of the smaller utilities." Marritz, *supra* note 8, at 27. Again, there are two sides. *See* Campbell, *supra* note 11, at 14 (acknowledging that NUGs need access, but cautioning that "our transmission networks have been designed primarily to maximize reliability, and not to serve as a 'common carrier' system").

30. Austin, *supra* note 14.

31. *E.g.*, Bickell, *The Antitrust Division's Adoption of a Chicago School Economic Policy Calls for Some Reorganization: But Is the Division's New Policy Here to Stay?* 20 HOUS. L. REV. 1083, 1099 (1983) ("Only the most prescient could have been predicted the boldness with which Professor Baxter has implemented his policy."); *see also* Adams & Brock, *The "New Learning" and the Euthanasia of Antitrust*, 74 CALIF. L. REV. 1515 (1986); Austin, *supra* note 14, at 941-48. During the Reagan Administration, the Department of Justice brought only one-fifth the amount of merger challenges as the Carter Administration. Axinn, *Developments in Mergers and Acquisitions*, 58 ANTITRUST L.J. 403, 407 (1989).

32. The Chicago School advocates that the priority of antitrust is efficiency, not "fuzzy sociological" goals of protecting small competitors. Austin, *supra* note 14, at 946. *See generally*, Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696 (1986); Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979). The practical effect of the Chicago School's influence is not altogether clear. As the Department of Justice has brought less actions, the opportunity for favorable precedent has diminished. "Despite a revolution, Chicago cannot cite a single Clayton 7 precedent of consequence." Austin, *supra* note 14, at 950.

33. Austin, *supra* note 14, at 935. There were also counter-critics. "Since 1981 the Reaganists have pursued unproven theories developed at the University of Chicago that supposedly foster competition and growth but actually promote monopoly." Shepherd, *Bust the Reagan Trustbusters*, FORTUNE, Aug. 4, 1986.

ing that antitrust principles have worked their way into FERC merger proceedings. According to the FERC, it will apply the antitrust laws (principally the Clayton Act, section 7) to its review of a merger application "to give understandable content to the broad statutory concept of the public interest."³⁴

The Clayton Act's prescription was simple: to prohibit a merger where "in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."³⁵ And so were its purposes: to stem "a rising tide of economic concentration in the American economy."³⁶ However, the subsequent case law has been described as "somewhat like the angels in Jacob's dream: enigmatic, difficult to explain, and seemingly headed in more than one direction at any given time."³⁷ Indeed, applying the Act, with economic theory, market definition, fashioning relief, etc., is not simple, and may be even more difficult in a heavily regulated field such as the electric utility industry.³⁸ With this in mind, the following encapsulates the basic antitrust law considerations in determining a merger's effect on competition, with special attention to electric utility merger applications at the FERC. It is not a complete survey; this has been accomplished quite admirably by other authors.³⁹

A. *Narrowing the Inquiry: Market Definition*

1. Product Markets

Market definition has two elements: a product market and a geographic market.⁴⁰ The product market, according to the Supreme Court, is "deter-

34. Opinion No. 318, Utah Power & Light Co., 45 F.E.R.C. ¶ 61,095, at 61,283 (1988).

35. 15 U.S.C. § 18 (1988). In 1986, the Reagan Administration proposed, and the Antitrust Section of the American Bar Association endorsed (with an important modification), amendments to § 7 to "codify" recent merger enforcement policies and practices. H.R. 4247, 99th Cong., 2d Sess., 132 CONG. REC. H653 (daily ed. Feb. 26, 1986); S. 2160, 99th Cong., 2d Sess., 132 CONG. REC. S2280 (daily ed. Mar. 7, 1986). The bill would have: (1) replaced the "incipiency" standard of "may be" or "tend to" with a standard of "significant probability" of an adverse effect on competition (the ABA recommend that it be changed to "reasonable probability"); (2) the words "lessen competition" would have been changed to "increase the ability to exercise market power;" and (3) an enumeration of factors to consider in addition to market share or concentration data would have been added. See ABA Section of Antitrust Law, *Report to the House of Delegates on Proposed Amendments to Section 7 of the Clayton Act*, 55 ANTITRUST L.J. 673, 674-675 (1986).

36. *Brown Shoe Co. v. United States*, 370 U.S. 294, 315 (1962).

37. Axinn, *Developments in Mergers and Acquisitions*, 58 ANTITRUST L.J. 403 (1989).

38. "[T]he art of evaluating competition is imperfect and uncertain. Economists understand that certain major factors—principally market concentration, entry conditions and factors encouraging or discouraging collusion—affect competition; but the forces determining competition are much too complex to be fully explained by the economist's models and rules of thumb." Hughes & Hall, *supra* note 28, at 250.

39. See 4 P. AREEDA & D. TURNER, ANTITRUST LAW §§ 900-1022 (1980); ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 147-86 (2d Ed. 1984 & Supp. 1988); Bouknight, *Mergers, Acquisitions, and Joint Ventures in Energy Industries*, in ENERGY LAW AND TRANSACTIONS, ch. 103 (1990).

40. "Congress neither adopted nor rejected specifically any particular tests for measuring the relevant markets, either as defined in terms of product or in terms of geographic locus of competition, with which the anticompetitive effects of a merger were to be judged." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

mined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."⁴¹ Each product market may also have submarkets subsumed within it.⁴²

The Department of Justice Merger Guidelines⁴³ apply a somewhat different methodology.⁴⁴ The Department defines a product market as "a group of products such that a hypothetical firm that was the only present and future seller of those products . . . could profitably impose a 'small but significant and nontransitory' increase in price."⁴⁵ In simple terms, where a monopolist would be frustrated in raising prices because buyers would turn to other products, the product market should include such products.⁴⁶ The Federal Trade Commission (FTC), however, has held that such increases in price are "often difficult to measure . . . directly," and thus it uses "surrogates" in defining the product and geographic markets.⁴⁷

In *Utah Power & Light Co.*, the Commission defined the product markets to be transmission and bulk power.⁴⁸ All parties were in agreement that bulk power was a market⁴⁹ and most agreed that transmission was a separate product market.⁵⁰ The Commission agreed, stating that "transmission is a separate product market from the bulk power market since it can be sold separately

41. *Id.* at 325.

42. The "practical indicia" relevant in specifying a submarket are "industry or public recognition of the submarket as a distinct economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct prices, sensitivity to price changes, and specialized vendors." *Id.*

43. Department of Justice, 1984 Merger Guidelines, 49 Fed. Reg. 26,823 (1984) [hereinafter Merger Guidelines]. The Guidelines outline the "present enforcement policy" of the Department, and are intended to "improve the predictability of the Department's merger enforcement policy." Merger Guidelines, *supra*, § 1, at 26,827. "[B]ecause the Justice Department is obviously one of the principal government agencies charged with the duty of enforcing the antitrust laws, I think its position is entitled to some consideration, particularly when elements of the [1968] Guidelines find support in the developing case law." *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506, 524 (3d Cir. 1969).

44. It should be noted that the Department of Justice Guidelines, though the most frequently cited agency guidelines, do not stand alone. "The principal intellectual challenge" to the Guidelines has come from the horizontal merger guidelines of the National Association of Attorneys General, 4 Trade Reg. Rep. (CCH) ¶ 13,405 (1987). Axinn, *supra* note 37, at 405-406. New York Attorney General Abrams has argued that with the "lax" enforcement policies of the Reagan Administration, state attorneys general must take an active role in protecting against "the unfettered exercise of market dominance by giants in the corporate world." Axinn, *supra* note 37, at 416. The Federal Trade Commission issued the FTC Statement Concerning Horizontal Mergers, 4 Trade Reg. Rep. (CCH) ¶ 13,200 (1982), which its Director has lamented is all too often overlooked. Zuckerman, *The FTC's Approach to Merger Analysis: Is Anyone Out There Paying Attention?*, 57 ANTITRUST L.J. 115 (1988).

45. Merger Guidelines, *supra* note 43, § 2.11, at 26,828.

46. While the Merger Guidelines do not explicitly discuss the "submarket" concept, the Guidelines recognize that price discrimination may be possible where buyers cannot easily substitute certain products. *Id.* § 2.13; see ABA ANTITRUST SECTION, *supra* note 39, at 153.

47. B.F. Goodrich Co., 4 Trade Reg. Rep. (CCH) ¶ 22,519, at 22,138. Many of these factors are enumerated in *Grand Union Co.*, 102 F.T.C. 812, 1041 (1985).

48. Opinion No 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,284 (1988).

49. As a frame of reference, nationally approximately 38% of all power is purchased at wholesale, with the other 72% produced and consumed internally by vertically integrated utilities. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 16-18.

50. All parties, except the applicants, defined transmission to be a product market. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,284 & n.115.

and one product cannot be substituted for the other.”⁵¹ In its recent hearing order in *Kansas City Power & Light Co.*, the Commission stated that “[a]s a general matter, there are two potential sources of market power”—control of generation and transmission assets.⁵² However, the Commission cautioned that its “decision in [*Utah Power & Light*] was not meant to reflect an industry-wide determination that the only relevant product markets to consider in merger proceedings are firm and non-firm power and firm and non-firm transmission.”⁵³

In *Public Service Company of Indiana*, not a merger case, the Commission stated that “all reasonable substitutes” should be included in the product market.⁵⁴ The Commission noted that “the boundary of the product market cannot be drawn with precision.”⁵⁵ There, it found that Public Service Company of Indiana’s (PSI’s) definition of the product market as excess generating capacity was “adequate.”⁵⁶

2. Geographic Markets

The Clayton Act prohibits mergers substantially affecting competition “in any section of the country.” The Supreme Court has interpreted the Clayton Act as intending “a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one.”⁵⁷ The Act “does not call for the delineation of a ‘section of the country’ by metes and bounds as a surveyor would lay off a plot of ground.”⁵⁸ The geographic market is “the area in which the seller operates and the area to which purchasers can practically turn” in purchasing the products in issue.⁵⁹

The approach of the Department of Justice Merger Guidelines is somewhat different, as discussed above. The “hypothetical monopolist test” focuses on the geographic area beyond which purchasers could not turn if faced with a price increase from a hypothetical monopolist. Or, in the Department’s words, “If firms located elsewhere readily could provide the relevant product to the hypothetical firm’s buyers in sufficient quantity at a comparable

51. *Id.* at 61,284. As a remedy, the Commission required the merging companies to provide *firm* transmission access, but not *nonfirm* access. This decision was reaffirmed on rehearing. Opinion 318-A, *Utah Power & Light Co.*, 47 F.E.R.C. ¶ 61,209, at 61,737-39 (1989). The Commission explained “we are not willing to conclude that the merged company will be able to exercise market power in the nonfirm market on a sustained basis.” *Id.* at 61,738.

52. *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097, at 61,286 (1990). In several nonmerger cases addressing proposals for market-based rates, the Commission indicated that bulk power and transmission were relevant product markets. See *TECO Power Servs. Corp.*, 52 F.E.R.C. ¶ 61,191, at 61,699 (1990); *Enron Power Enter. Corp.*, 52 F.E.R.C. ¶ 61,193, at 61,708, 61,711 (1990); *Portland Gen. Exch., Inc.*, 51 F.E.R.C. ¶ 61,108, at 61,248-51 (1990); *Commonwealth Atl. Ltd. Partnership*, 51 F.E.R.C. ¶ 61,368, at 62,244 (1990); *Doswell Ltd. Partnership*, 50 F.E.R.C. ¶ 61,251, at 61,757-58 (1990).

53. *Kansas City*, 53 F.E.R.C. ¶ 61,097, at 61,286.

54. Opinion No. 349, *Public Serv. Co. of Ind.*, 51 F.E.R.C. ¶ 61,367, at 62,205 (1990).

55. *Id.*

56. *Id.* The Judge in *Northeast Utilities* also found excess generating capacity to be a market. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,215 (1990) (decision of administrative law judge).

57. *Brown Shoe Co. v. United States*, 370 U.S. 294, 336 (1962).

58. *United States v. Pabst Brewing Co.*, 384 U.S. 546, 549 (1966).

59. *Brown Shoe*, 370 U.S. at 336.

price, an attempt to raise price would not prove profitable, and the tentatively identified geographic area would prove to be too narrow.”⁶⁰

In *Utah Power & Light*, the Commission found the geographic market for bulk power was the area covered by the Western Systems Coordinating Council (WSCC).⁶¹ With respect to transmission, the FERC held that three “paths” (or corridors) constituted the relevant geographic market.⁶² Each transmission path provided a link between groups of purchasers and sellers of bulk power, two of which allowed “abundant low-cost power generated in the Northwest [to] be sold to buyers in the Southwest.”⁶³

In its hearing order in *Kansas City Power & Light*, the FERC seemed to recognize the possibility of “smaller geographic market[s]” due to the ability of a firm to price discriminate.⁶⁴ The Commission asked whether there could be “transmission bottlenecks limiting the ability of buyers in one area to access suppliers in another area.”⁶⁵

B. Principles Applicable to Horizontal Mergers

Mergers between firms operating in the same product and geographic markets are called “horizontal.” Antitrust authorities are concerned with such mergers because, by definition, they reduce the number of competitors in a market and increase market concentration.⁶⁶ A merger’s effect on the concentration of firms in a market is a source of worry because “there is general agreement . . . that an undue reduction in the number of competing sellers, or undue concentration of sales in the hands of a few relatively large sellers, is likely to lead to non-competitive pricing, either through recognized interdependence or actual collusion or both.”⁶⁷ Applying this understanding to par-

60. Merger Guidelines, *supra* note 43, § 2.31, at 26,829. The Department considers various factors, including: (a) shipment patterns of firms in the product market; (b) evidence of actual changes in buyers’ purchasing choices between different geographic areas; (c) price movements between geographic areas; (d) transportation costs; (e) costs of local distribution; and (f) excess capacity of firms distant from the merging firms. *Id.* § 2.32.

61. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,284.

62. *Id.* at 61,285. The presiding administrative law judge held that the entire WSCC region was the appropriate geographic market for transmission. *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,358 (1988).

63. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,285.

64. *Kansas City*, 53 F.E.R.C. ¶ 61,097, at 61,287.

65. *Id.* In *Public Service Co. of Indiana*, the Commission stated “The geographic market for each eligible customer is defined by the customer’s ability to obtain transmission to connect it to relevant generation sources.” Opinion No. 349, Public Serv. Co. of Ind., 51 F.E.R.C. ¶ 61,367, at 62,206 (1990).

66. Horizontal mergers can consolidate sellers or buyers of products. The article does not break out a separate discussion of buyer market power (monopsony), although there are separate concerns. See P. AREEDA & D. TURNER, *supra* note 39, §§ 963-965.

67. P. AREEDA & D. TURNER, *supra* note 39, § 908, at 27 (1980). See also Whalley, *Department of Justice Merger Enforcement*, 57 ANTITRUST L.J. 109, 110 (1988) (stating that “as markets become significantly more concentrated the risk of the exercise of market power increases”).

This assumption has been questioned as applied to a global marketplace. “[C]onventional assumptions involving domestic market concentration and the consequences of ‘market power’ are questionable, if not irrelevant to the world market.” Austin, *supra* note 14, at 959. “In markets where international trade exists or could exist, national antitrust laws no longer make sense.” L. THURLOW, *THE ZERO-SUM SOCIETY* 146 (1980).

ticular mergers, however, is difficult because "neither economic theory nor empirical evidence specifies the minimum number of sellers normally necessary for effective price competition or the level of concentration among leading firms normally impeding it."⁶⁸

The Supreme Court in *United States v. Philadelphia Bank* sought to "simplify the test of illegality" by allowing courts to rely on market share and concentration figures as presumptive proof of a merger's illegality.⁶⁹ The Court held "we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."⁷⁰ The bank merger there resulted in a merged firm with 30% of the market, and the four largest firms had more than 70% of the market.⁷¹

In *United States v. Von's Grocery Co.*,⁷² the Court found unlawful a merger between grocery stores with a much smaller market share, 8.9%. The Court found a significant trend toward competition in the local Los Angeles grocery market.⁷³ During the 1960's, the Court found mergers unlawful in the following cases (with the merged firm's market share in parenthesis): *United States v. Aluminum Co.*⁷⁴ (29.1%); *United States v. Continental Can Co.*⁷⁵ (25%); *United States v. Pabst Brewing Co.*⁷⁶ (24%, 11.3%, and 4.5% in three different markets); *United States v. Third National Bank*⁷⁷ (38.4%); and

68. P. AREEDA & D. TURNER, *supra* note 39, at 27.

There is extensive professional economic literature on the empirical relationship between market concentration and measures of the exercise of market power The only general conclusion that can be drawn from the theoretical and empirical literature is that a market with low concentration will almost surely exhibit competitive behavior and results; however, a concentrated market may or may not, depending especially on entry conditions and also on other factors that can affect the market.

Hughes & Hall, *supra* note 28, at 255.

69. *United States v. Philadelphia Bank*, 374 U.S. 321, 363 (1963).

Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.

Brown Shoe Co. v. United States, 370 U.S. 294, 322 n.38 (1962).

70. *Philadelphia Bank*, 374 U.S. at 363.

71. P. AREEDA & D. TURNER, *supra* note 39, § 909, at 31.

72. 384 U.S. 270 (1966).

73. "If concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great." *United States v. Aluminum Co.*, 377 U.S. 271, 279 (1964). See also *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,343 (1988) (stating that "[a] decisive factor in anti-trust evaluations under Section 7 of the Clayton Act is whether there is a tendency towards concentration"). This rationale has been criticized. "The [Supreme Court's] opinions do not adequately describe either the relevance of a trend to concentration or how a trend affects the market share size that will be taken as presumptive proof of illegality." P. AREEDA & D. TURNER, *supra* note 39, § 909, at 32.

74. 377 U.S. 271 (1964).

75. 378 U.S. 441 (1964).

76. 384 U.S. 546 (1966).

77. 390 U.S. 171 (1968).

*United States v. Phillipsburg National Bank & Trust Co.*⁷⁸ (19.3%).⁷⁹

The Court's decisions exhibited concern for the preservation of small businesses. In *Brown Shoe Co. v. United States*, the Court found that Congress intended "to promote competition through the protection of viable, small, locally owned businesses."⁸⁰ And in *Von's Grocery*, the Court stated that the Act was intended to "keep[] a large number of small competitors in business."⁸¹ The Court found that Congress was aware that maintaining such "fragmented industries" could result in "occasional higher costs and prices."⁸² Certain antitrust scholars have been scathing in their criticism of such statements, arguing that the implication is that the Court was willing to protect competitors, not competition.⁸³

The 1974 decision in *United States v. General Dynamics Corp.*⁸⁴ has been said to have signalled a departure from this view. There, the Court was confronted with market shares and concentration ratios in a merger of coal companies that, in other instances, would have supported prima facie evidence of illegality.⁸⁵ However, the Court found no violation of the Clayton Act largely on the basis that the acquired company's historical market share was not relevant. This was because the company's coal reserves were either largely depleted or otherwise committed to long-term contracts, and it was unlikely to acquire or develop new ones.⁸⁶ Thus, the Court found that the loss of this "competitor" would not substantially harm competition.⁸⁷

In recent years, courts and the enforcement agencies have increasingly

78. 399 U.S. 350 (1970).

79. Each of the market share figures were derived from P. AREEDA & D. TURNER, *supra* note 39, § 909, at 31.

80. *Brown Shoe Co. v. United States* 370 U.S. 294, 344 (1962). "Throughout the history of these statutes [the antitrust laws] it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429 (2d Cir.). "Although the meaning of 'competition' was not discussed, the debate suggests reliance upon a structural theory of competition which stresses the advantages of a large number of small-sized businesses." *United States v. Kennecott Copper Corp.*, 231 F. Supp. 95, 103 (S.D.N.Y. 1964).

81. *Von's Grocery*, 384 U.S. at 275.

82. *Brown Shoe*, 370 U.S. at 344.

83. *E.g.*, Bork & Bowman, *The Crisis in Antitrust*, 65 COLUM. L. REV. 363 (1965). "No matter how many times you read it [the *Brown Shoe* quote], that passage states: Although mergers are not rendered unlawful by the mere fact that small independent stores may be adversely affected, we must recognize that mergers are unlawful when small independent stores may be adversely affected." *Id.* at 373; *see also* ABA Antitrust Section Report, *supra* at 677 (Warren Court decisions "focused attention on social policies not necessarily consistent with economic principles and consumer welfare."). Other scholars have disagreed. "There is no reason to believe" that Congress intended that economic efficiency alone would be the "narrow purpose" of the antitrust law. Axinn, *supra* note 37, at 404. "One cannot seriously question the political nature" of the Clayton Act, which was concerned with "halt[ing] the acquisition of private economic power." *Id.* at 404.

84. 415 U.S. 486 (1974).

85. *Id.* at 1192-97.

86. *Id.* at 1197-99.

87. Another example is *United States v. Waste Management, Inc.*, 743 F.2d 976 (2d Cir. 1984), where the Second Circuit found that the combined market share of 48.8% for the merging companies did not warrant a finding of illegality on the basis that barriers to entry in the trash collection market were virtually nonexistent. *Id.* at 981.

relied on factors in addition to market share and concentration analyses. “[S]tarting with *General Dynamics*, the focus of merger analysis moved away from simple bright line rules based only on market share and concentration numbers which treated all markets and all companies alike, to an evaluation of the economic and business realities of a merger.”⁸⁸ According to the ABA Antitrust Section, since *General Dynamics*, lower courts have looked “beyond market share and concentration levels to more particularized economic evidence bearing on competitive effort.”⁸⁹ And the FTC has held that “recent empirical economic research and well over a decade of practical experience” have justified “greater consideration of evidence beyond mere market shares when such evidence is available and in reliable form.”⁹⁰ For example, in addition to concentration levels, the FTC will look at barriers or impediments to entry, elasticity of demand, homogeneity of products, the number of buyers, the frequency and size of transactions, and stability of supply and demand conditions.⁹¹

The Department of Justice’s Merger Guidelines came on the heels of these changes in antitrust thinking. The Guidelines focus on market concentration, which, according to the Department, “affects the likelihood that one firm, or a small group of firms, could successfully exercise market power.”⁹² The level of concentration is important because “the smaller the percentage of total supply that a firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable.”⁹³ To measure market concentration, the Department uses the Herfindahl-Hirschman Index (HHI).⁹⁴ An HHI is calculated by summing the squares of the market shares of all firms in a market. Unlike the four-firm concentration ratio,⁹⁵ the HHI measures all firms in the market.⁹⁶

88. Whalley, *supra* note 67, at 109.

89. ABA Section of Antitrust Law, *supra* note 35, at 684.

90. FTC Statement Concerning Horizontal Mergers, 4 Trade Reg. Rep. (CCH) ¶ 13,200 (1982).

91. B.F. Goodrich Co., 5 Trade Reg. Rep. (CCH) ¶ 22,519, at 22,142 (1988). See Zuckerman, *supra* note 44, at 118-123.

92. Merger Guidelines, *supra* note 43, § 3.1, at 26,830.

93. *Id.* Also, “as the number of firms necessary to control a given percentage of total supply increases, the difficulties and costs of reaching and enforcing consensus with respect to the control of that supply also increase.” *Id.*

94. The FTC “has not endorsed . . . the numerical thresholds and tests for analyzing mergers contained in the Justice Guidelines.” *American Medical Int’l*, 104 F.T.C. 1,200.

95. The four-firm ratio measures the size of the largest four firms in the market. Ordinarily a certain percentage is selected, say 70%, as a threshold beyond which the market would be deemed highly concentrated and noncompetitive. See P. AREEDA & D. TURNER, *supra* note 39, § 909, at 29 (using 70% as a presumptive cutoff).

96. Merger Guidelines, *supra* note 43, § 3.1, at 26,830. The Guidelines adopt three different threshold levels of concentration to “screen” out mergers that presumptively do not harm competition and require little detailed analysis. Where the merger occurs in a market with an HHI less than 1000, the Department will not challenge the merger “except in extraordinary circumstances.” *Id.* § 3.11(a), at 26,831. If the HHI falls between 1000 and 1800, the Department will “likely” challenge the merge if the merger causes a 100 point or greater HHI increase. *Id.* § 3.11(b). In a market with an HHI exceeding 1800, the Department will “likely” challenge a merger if it causes a 50 point increase, unless other factors, discussed below, indicate a competitive market; and if it “substantially” exceeds 1800, these “other factors” will play a

The Department is quick to caution that “market share and concentration data provide only the starting point for analyzing the competitive impact of a merger.”⁹⁷ If a merger occurs in a moderately or highly concentrated market, the Department will consider several characteristics that affect the particular market’s likely competitiveness, including: (a) whether ongoing changes in the market’s structure overstate or understate particular market shares;⁹⁸ (b) whether the underlying structural weakness of a firm overstates its competitive significance;⁹⁹ (c) whether new firms would encounter substantial barriers to entering the market;¹⁰⁰ (d) whether the product being sold is homogeneous, and thus potential colluders need only agree on a uniform price;¹⁰¹ (e) whether the next-best substitute is a “good” substitute, and thus might be turned to in the event of a price increase;¹⁰² and (f) whether there is information widely available about specific transactions, thus facilitating collusive behavior.

The FERC has not yet formally adopted specific market share thresholds, the HHI, or firm concentration ratios. In *Public Service Company of Indiana*, the Commission acknowledged that there were “various methods of analyzing market power” but said “we do not believe that any one type of evidence is sufficient for this analysis, and we will not rely on any mechanical market share analysis to determine whether a firm has market power.”¹⁰³ Continuing, the Commission explained that “[m]arket concentration figures alone do not demonstrate the existence, or lack, of market power.”¹⁰⁴ However, in *Buckeye Pipe Line Co.*, the Commission held that “[f]or measuring market concentration, we conclude that a proper screening device is an HHI.”¹⁰⁵

decisive role only in “extraordinary cases.” *Id.* § 3.11(c). The Department is also “likely” to challenge a merger between a firm with a 35% market share and another firm with at least 1% of the market, regardless of the specific competitive characteristics of the market. *Id.* § 3.12. This is “[b]ecause the ease and profitability of collusion are of little relevance to the ability of a single dominant firm to exercise market power.” *Id.*

In the period between 1983 and 1988, the Justice Department challenged mergers involving HHIs ranging from 1200 to 10,000, but also found mergers in markets with a 4000-5000 HHI to be permissible, given low barriers to entry or other factors. Whalley, *supra* note 67, at 110.

97. Merger Guidelines, *supra* note 43, § 3.11, at 26,831.

98. *Id.* § 3.21, at 26,831.

99. *Id.* § 3.22, at 26,832.

100. *Id.* § 3.3.

101. *Id.* § 3.411.

102. *Id.* § 3.413, at 26,833. Bouknight, *supra* note 39, § 103.02[4], at 103-23.

103. Opinion No. 349, Public Serv. Co. of Ind., 51 F.E.R.C. ¶ 61,367, at 62,205 (1990). The Commission found that PSI did not have market power on the basis of several facts, including: (a) it had a small percentage of total excess generation capacity in the market (less than 20% by PSI’s calculations); (b) PSI’s competitors would have access to a variety of alternative suppliers; (c) PSI’s competitors were “sophisticated buyers” able to take advantage of such options; and (d) the transmission tariff offered by PSI increased the range of options available, and was “essential” in mitigating market power. *Id.* at 62,209.

104. *Id.* Joskow and Schmalensee looked at concentration of generation nationally, broken down roughly by Standard Metropolitan Statement Areas (SMSAs). They found there to be significant concentration in various parts of the country, but cautioned that the lack of information on transmission constraints limited the usefulness of the analysis. The conclusion drawn was that there was “significant uncertainty” that effective competition post-deregulation would occur in many areas of the country. JOSKOW & SCHMALENSEE, *supra* note 14, at 190.

105. Opinion No. 360, 53 F.E.R.C. ¶ 61,473, at 62,667 (1990).

In *El Paso Natural Gas Co.*, the FERC held that the HHI “is not a measure of . . . market power alone. Rather, it is a measure of *market concentration* and, as such, is an indicator of the likelihood that [the applicants] together with other suppliers can jointly exercise market power in a given market.”¹⁰⁶ Seller “market power” is where “the seller can significantly influence the price in the market by withholding service and excluding competitors for a significant period of time.”¹⁰⁷

How has the Commission treated horizontal mergers? In *Utah Power & Light Co.*, the administrative law judge found that PP&L and UP&L were in competition in the bulk power and transmission markets,¹⁰⁸ and that the merger posed potential harm to competition in these markets. The judge, however, declined to make “Solomon-like” determinations on the HHI calculations presented by the various economists.¹⁰⁹

The Commission affirmed the judge’s findings, but likely because of its concern over UP&L’s control of bottleneck transmission facilities, there was only limited discussion of market shares and concentration measures. The Commission noted that UP&L and PP&L each had control of portions of two of the three transmission markets (corridors) identified by the Commission.¹¹⁰ The Commission found that the merged company would control 88.2% of one of these paths. The Commission also referred to certain HHI calculations, and stated that an “evaluation of concentration of ownership” of transmission assets “leads to the same conclusion,” that the merger would harm competition.¹¹¹

The judge in *Southern California Edison Co.* found that the merging companies competed in several transmission service “corridor” markets,¹¹² and that there were only limited alternatives to suppliers on these corridors. There

106. Opinion No. 336, 49 F.E.R.C. ¶ 61,262, at 61,910 n.44 (1989).

107. TECO Power Servs. Corp., 52 F.E.R.C. ¶ 61,191, at 61,697 n.42 (1990). A lack of market power means the seller “could not significantly influence the price” paid by the utility purchaser. Commonwealth Atl. Ltd. Partnership, 51 F.E.R.C. ¶ 61,368, at 62,249 (1990). In its IPP Proposed Rule, the Commission defined “market power” as “the ability to influence the price that customers in a particular area must pay for a product,” and “significant market power” as “the ability to set and maintain a price in excess of the cost of competitively supplied generation.” Notice, *Regulations Governing Independent Power Producers*, IV F.E.R.C. Stats. & Regs., ¶ 32,456, at 32,109 (1988). “The essential characteristic of a buying utility’s vulnerability to a seller’s exercise of significant market power is that the buying utility is able to create supply alternatives only with great difficulty, and at a high cost.” *Id.*

108. *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,357 (1988).

109. *Id.* at 65,347.

110. The Commission found that the “eastern corridor” from the Northwest to the Southwest was “predominantly controlled by UP&L and PP&L.” Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,285 (1988). The transmission path from the Rocky Mountain area to the Northwest was also primarily controlled by the merging companies (PP&L 72.5%; UP&L 15.7%). *Id.* at 61,286-87. The “western corridor” from the Northwest to the Southwest was controlled primarily by the Bonneville Power Administration, with some control by PP&L. *Id.* at 61,285.

111. *Id.* at 61,286 n.127. The Commission noted that an HHI calculation by the “applicant’s own witness” substantially exceeded 1800, and thus indicated a highly concentrated transmission market. That analysis had found a premerger HHI of 3029, and a post-merger HHI of 3091 for transmission to the Southwest. *Id.* The Commission noted an HHI calculation for the Northwest-to-Rocky Mountain transmission market of 5,643 pre-merger, with an increase of 2,277 due to the merger. *Id.* at 61,287 n.135.

112. *Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014, at 65,102 (1990).

were, at most, one or two other potential transmission service providers on each corridor.¹¹³ The administrative law judge gave the HHI a narrow application, stating that if the Department of Justice had challenged the merger, the HHI would have been discussed, but otherwise “[t]he HHI is of no use to the Commission because the Commission is not challenging the merger.”¹¹⁴

In *Northeast Utilities Service Co.*, the judge found the merger anticompetitive where the combination of PSNH and NU transmission facilities would give the merged company “92% of the [transmission] capacity available for transmission to New England.”¹¹⁵ The judge found that the “merger would leave 45 Eastern REMVEC utilities ‘isolated’ inside the curtain” of the Northeast transmission system, but stopped short of finding it to be an essential facility.¹¹⁶ The judge also found the combination would produce “the single largest source of surplus [generating] capacity in New England.”¹¹⁷ The judge found no use for HHIs or other Merger Guidelines concepts, given his findings that NU would have a transmission “curtain” around Eastern Massachusetts and Rhode Island.¹¹⁸ “An examination of the disputed numerical devices would serve no useful purpose in the circumstances of this case.”¹¹⁹

C. Principles Applicable to Vertical Mergers

A merger is said to be “vertical” when it combines entities that are or could be in a buyer-seller relationship, i.e., operating at different levels of the production and distribution process.¹²⁰ There is lively debate over how courts and enforcement bodies should treat vertical mergers.¹²¹

The Supreme Court in *Brown Shoe* took a tough stance toward vertical mergers. The Court described them as a potential “clog on competition,” and stated that “every extended vertical arrangement” denies competitors an “opportunity to compete.”¹²² The Court held the merger between shoe manu-

113. *Id.* at 65,105.

114. *Id.* at 65,107 n.34.

115. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,215 (1990) (decision of administrative law judge).

116. *Id.*

117. *Id.*

118. “[T]here is no need in this case to resolve disputes about the relative significance of various Herfindahl-Hirschman Index (HHI) numbers . . . or of the Guidelines themselves in the context of an electric utility merger.” *Id.* at 65,219.

119. *Id.*

120. The Supreme Court has described verticality as “[e]conomic arrangements between companies standing in a supplier customer relationship.” *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

121. Prior to the Celler-Kefauver Clayton Act amendments of 1950, it was thought that the Act applied only to horizontal mergers, not vertical mergers. P. AREEDA & D. TURNER, *supra* note 39, § 902, at 7. The amendments made the Act’s application to vertical mergers clear. *Brown Shoe*, 370 U.S. at 317. See also H.R. Rep. No. 1191, 81st Cong., 2d Sess. 8, 11 (1949) (Act “applies to all types of mergers and acquisitions, vertical and conglomerate, as well as horizontal.”).

122. *Brown Shoe*, 370 U.S. at 323-24.

The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a ‘clog on competition,’ which ‘deprive[s] rivals of a fair opportunity to compete.’ Every extended vertical arrangement by its very nature, for at least a time, denies to

facturer and distributor to be unlawful, even though the acquired firm's share in the relevant markets ranged from 1% to 2%.¹²³

Some commentators have argued that the harmful effects of vertical merger are so improbable and the likely efficiency gains so likely that vertical mergers should be *per se* lawful.¹²⁴ Other scholars have recognized that vertical mergers may pose competitive problems but nevertheless argue that *Brown Shoe* was "indefensible."¹²⁵ The starting point for these scholars is that "[a] vertical merger, standing alone, does not alter concentration either in the supplier's market or in his customer's markets, and hence adds nothing to whatever market power either firm previously had."¹²⁶ The Department of Justice Guidelines express a similar point, but caution that vertical mergers "are not invariably innocuous."¹²⁷

Taking the case law and commentary together, vertical mergers potentially raise several concerns.¹²⁸ The first, and perhaps one relied upon most frequently by the courts, is foreclosure.¹²⁹ The Court in *Brown Shoe* identified foreclosure as the "primary vice" of a vertical merger.¹³⁰ A vertical merger

competitors of the supplier the opportunity to compete for part or all of the trade of the customers-party to the vertical arrangement.

Id.

123. *Id.* at 334.

124. BORK, *THE ANTITRUST PARADOX* 245 (1978). See also the statement of Antitrust Division Chief William Baxter: "As far as I'm concerned there is no such thing as a vertical merger. . . . Mergers are never troublesome except insofar as they give rise to horizontal problems . . ." *Antitrust & Trade Reg. Rep.* (BNA) No. 1027, at A-5 (Aug. 13, 1981).

125. P. AREEDA & D. TURNER, *supra* note 39, § 1022, at 314.

126. *Id.* § 1000, at 207.

First, the vertical fusion does not in itself increase market concentration in either of the participating firms' markets. Second, the vertical merger does not necessarily eliminate any competitors from the market. Finally, vertical integration of function and the efficiencies it produces are less likely to be achieved if the acquirer is forced to enter a new market by internal expansion (with its concomitant capital outlay) than if the integration can be accomplished through acquisition.

3 V. KALINOWSKI, *ANTITRUST LAWS AND TRADE REGULATION* § 17.03[3], at 17-22 (1989).

127. Merger Guidelines, *supra* note 43, § 4.0, at 26,834. "By definition, non-horizontal mergers involve firms that do not operate in the same market. It necessarily follows that such mergers produce no immediate change in the level of concentration in any relevant market as defined in Section 2 of these Guidelines." *Id.*; see generally Williamson, *Vertical Merger Guidelines: Interpreting the 1982 Reforms*, 71 CALIF. L. REV. 604 (1983).

128. The Court in *Brown Shoe* identified two concerns in addition to those discussed here. An "important" factor in analyzing vertical foreclosure is the "nature and purpose of the arrangement." *Brown Shoe*, 370 U.S. at 329. Where a vertical integration, like a tying arrangement, "forces the customer to take a product or brand he does not necessarily want," it may be considered "inherently anticompetitive." *Id.* at 330; see also Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,288 n.149 (1988) (the "ability to favor its own generation arises from the vertical combination of essential transmission facilities with PP&L's excess generation"). A "trend toward concentration" in the industry is also a factor. *Brown Shoe*, 370 U.S. at 332; see *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,343 (1988) ("A decisive factor in anti-trust evaluation . . . is whether there is a tendency toward concentration.").

129. "[F]oreclosure is simply pre-emption from a share of the market." *United States v. Kimberly-Clark Corp.*, 264 F. Supp. 439, 464 (N.D. Cal. 1967).

130. *Brown Shoe*, 370 U.S. at 324. A vertical merger may harm competition where it "foreclose[s] competitors of the purchasing firm in the merger from access to a potential source of supply, or from access on competitive terms." *Fruehauf Corp. v. FTC*, 603 F.2d 345, 352 (1979); accord *Crouse-Hinds Co. v.*

may foreclose competitors from making sales to the customer firm or making purchases from the supplier firm.¹³¹ Such purchases and sales would, post-merger, be internal transactions not subject to competitive pressures.¹³² In *Ford Motor Co. v. United States*, the Court found the merger to violate the Clayton Act, in part, because it resulted in “the foreclosure of Ford as a purchaser of about ten percent of total industry output.”¹³³

A second concern is that such a merger would increase the barriers to entry in one of the two markets. One possibility is that a new entrant would be required to enter both markets simultaneously.¹³⁴ Efficiencies of scale could also impede entry where the market has narrowed to a point where available sales do not support an efficient scale,¹³⁵ or there are differing optimal plant sizes in the two markets, causing the entrant to endure an inefficient operation at one level.¹³⁶ Entry could also be restricted by “decreasing the availability of an important source of supply, and increasing the possibility of, or the potential entrant’s fear of, a price squeeze or refusal to deal.”¹³⁷ The Court, in rejecting the merger in *Ford Motor Co.*, accepted the district court’s finding that the merger “had the effect of raising the barriers to entry into that

Internorth, Inc., 518 F. Supp. 416, 430 (N.D.N.Y. 1980) (vertical merger may “reduce competition by . . . foreclosing competitors of the acquiring firm from access to sources of supply, or from access on competitive terms”).

131. P. AREEDA & D. TURNER, *supra* note 39, § 1004; ABA ANTITRUST SECTION, *supra* note 39, at 174; *Ford Motor Co. v. United States*, 405 U.S. 562, 566-69 (1972); *Brown Shoe*, 370 U.S. at 328-34.

132. In some cases, a competitor could make up for the foreclosure by simply “shifting” its purchases to another supplier or its sales to another purchaser. See *Fruehauf Corp.*, 603 F.2d at 360 (merger would not “deprive[] rivals from major channels of distribution” where “there would merely be a realignment of existing market sales without any likelihood of a diminution in competition”); *Crouse-Hinds Co.*, 518 F. Supp. at 433 (merger lawful where no evidence that “rivals will be unable to purchase products from [acquired firm] after the merger or to find other sources of supply at competitive prices and quality”). However, where there is scarcity in the supplied product, a vertical foreclosure may be “economically disastrous” to competitors. 3 V. KALINOWSKI, *supra* note 147, § 17.03[3], at 17-25 (“foreclosure may be economically disastrous to . . . competitors at times when [products] are in short supply”); *id.* at 17-24 (foreclosure “especially critical if . . . competitors are unable to find a new source of supply”); accord 2 FOX & FOX, CORPORATE ACQUISITIONS AND MERGERS, § 9.02[2], at 9-5 (where product “in short supply” merged company’s “competitors may not be able to obtain sufficient [quantities] to fill their needs”). This adverse effect may be partially alleviated if all firms, including the merged firm’s division, are treated equally in shortage situations. See *Fruehauf Corp.*, 603 F.2d at 355 (vertical merger lawful where company had “pro rata allocation” policy “in times of shortage”); *United States v. Kennecott Copper Corp.*, 231 F. Supp. 95, 105 (S.D.N.Y. 1964) (merger’s effect on supply shortage not a concern where “[d]uring periods of shortage . . . [merged company] has sold its [product] on an allocation system based on past purchases”).

133. *Ford Motor Co. v. United States*, 405 U.S. 562, 567-68 (1972). The Department of Justice Merger Guidelines, however,

are not concerned with ‘foreclosure’ as such or with the possible use of vertical integration to ‘leverage’ monopoly power from one market into another. Instead, the Department recognizes only three possible anticompetitive effects: that vertical mergers might create entry barriers, facilitate horizontal coordination, or allow a regulated firm to evade rate regulation.

P. AREEDA & D. TURNER, *supra* note 39, § 1015.1, at 868 (Supp. 1990).

134. P. AREEDA & D. TURNER, *supra* note 39, § 1011, at 244; Merger Guidelines, *supra* note 43, § 4.212, at 26,835; 2 FOX & FOX, *supra* note 133, § 9.02[3], at 9-29.

135. P. AREEDA & D. TURNER, *supra* note 39, § 1008, at 236; 2 FOX & FOX, *supra* note 133, at 9-29.

136. Merger Guidelines, *supra* note 43, § 4.212, at 26,835.

137. 2 FOX & FOX, *supra* note 133, at 9-29.

market.”¹³⁸

A third form of potential competitive harm could occur if the merger eliminated a “disruptive buyer.”¹³⁹ The Department of Justice Guidelines identify this as a problem where “the upstream market is generally conducive to collusion and the disruptive firm is significantly more attractive to sellers than the other firms in its market.”¹⁴⁰

A vertical merger also could be deemed to facilitate a price squeeze or price discrimination.¹⁴¹ One court observed that a “handful of leading vertically integrated firms” can use pricing to “punish an aggressive marketeer or price-cutter[;] . . . to woo away a crucial account of a nonintegrated concern; or to maintain respective oligopoly shares.”¹⁴²

A final concern, articulated by the Department of Justice Guidelines, involves facilitating evasion of rate regulation. This occurs most commonly where the merger involves a regulated public utility and a supplier of one of its inputs. In such a case, “the utility would be selling to itself and might be able arbitrarily to inflate the prices of internal transactions. Regulators may have great difficulty in policing these practices.”¹⁴³

How has the FERC reacted to this debate? The judge in *Utah Power & Light* found the “vertical integration” caused by the merger to be anticompetitive.¹⁴⁴ He held that “the combination of PP&L’s low cost power resources having preferential access to UP&L’s transmission system” would “create just the sort of undue market power” the antitrust laws sought to prevent.¹⁴⁵ The Commission agreed. It found PacifiCorp could “foreclose competition” by giving “preference to its own generation over that of its competitors for sales

138. *Ford Motor Co.*, 405 U.S. at 568.

139. Merger Guidelines, *supra* note 43, § 4.222, at 26,836; P. AREEDA & D. TURNER, *supra* note 39, § 1001, at 212.

140. Merger Guidelines, *supra* note 43, § 4.222, at 26,836; *see also* P. AREEDA & D. TURNER, *supra* note 39, § 1001, at 212 (suggesting that elimination of a “large buyer” can be a problem where the buyer market is competitive, and the seller market is noncompetitively structured, except that suppliers are actually pricing competitively due to pressure from, in part, the “large buyer”).

141. P. AREEDA & D. TURNER, *supra* note 39, § 1000, at 209; ABA ANTITRUST SECTION, *supra* note 39, at 174-75.

142. *United States Steel Corp. v. FTC*, 426 F.2d 592, 603 (6th Cir. 1970).

143. Merger Guidelines, *supra* note 43, § 4.23, at 26,836. This concern led the FTC to challenge a merger of a natural gas pipeline and a producer. *See* the discussion of MidCon Corp/Occidental Petroleum merger in Bouknight, *supra* note 39, § 103.03[5], at 103-36.

144. *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,344 (1988). The same judge in *Southern California Edison* found a similar type of vertical integration: “The vertical aspects occur because Edison is buying its sole supplier of long-term firm transmission service between its control area and the Mexican border, and, because Edison is buying a customer of both firm and non-firm transmission service.” *Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014, at 65,107 (1990).

145. *Utah*, 43 F.E.R.C. ¶ 63,030, at 65,344.

The combination of Applicants’ generation and transmission facilities would result in a vertically integrated company, with market power in one stage of production (i.e., transmission of electricity) that would enable it to affect adversely competition in another stage of production (i.e., bulk power sales) with a resultant preclusion of direct competition and increased barriers to entry.

Id. at 65,359.

into southwestern markets (even when the latter is cheaper)."¹⁴⁶ This "ability to favor its own generation arises from the vertical combination of essential transmission facilities with PP&L's excess generation."¹⁴⁷

A different issue of vertical integration arose in *Southern California Edison Co.* There, certain parties alleged that the combination of SCEcorp's Mission Energy unit (an unregulated supplier of bulk power) with SDG&E, which was generation-short, increased the potential for evasion of rate regulation. The parties argued that such evasion had already occurred in QF contracts between Mission and Edison, causing Edison's customers to bear unnecessary costs.¹⁴⁸ Edison countered that such mark-ups on sales by Mission Energy had not occurred, that the FERC specifically permits such affiliate transactions under PURPA, and that the California Public Utilities Commission was more than able to effectively regulate such affiliate transactions.

The presiding judge sided with the intervenors. He found that "there is an inherent likelihood that the merger will shield certain matters from the regulatory review process."¹⁴⁹ The judge believed that Edison could likely favor its own QF suppliers over nonaffiliated QFs, stating that "there are inherent difficulties in the CPUC's monitoring the range of potential power supply options." There would be no meaningful competition, he held, "if Edison can simply ignore the existence" of nonaffiliated competitors.¹⁵⁰

In *Northeast Utilities*, the judge found vertical effects from the "combining into one entity control over the single largest source of surplus capacity in New England with control over key transmission facilities necessary to provide access to alternative sources of bulk power in the region."¹⁵¹ This vertical integration, the judge found, would allow NU to "favor[] its own excess generation at high prices."¹⁵² "[T]he excess capacity creates a motivation for the merged company to favor its own 'unsold peanuts' over someone else's—even if the other suppliers' goods are cheaper."¹⁵³

D. Principles Applicable to Conglomerate Mergers

A merger that does not fall under the description "horizontal" or "vertical" will likely be characterized as "conglomerate." A conglomerate merger can be (1) a joining of companies that are engaged in wholly unrelated lines of commerce, or (2) a "market extension" merger, where the two firms sell related but different products (product extension), or sell the same product in different geographic areas (geographic extension).¹⁵⁴

146. Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,288 (1988).

147. *Id.* n.149.

148. Analogies were drawn to *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

149. *Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014, at 65,110 (1990).

150. *Id.* at 65,112.

151. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,215 (1990) (decision of administrative law judge).

152. *Id.*

153. *Id.* at 65,215-16.

154. ABA ANTITRUST SECTION, *supra* note 39, at 178.

The most typical concern over conglomerate mergers is whether the merger will eliminate existing potential competition. This can occur where one firm is in a highly concentrated market, and the other firm is on the fringe of the market and is perceived to be a possible new entrant. The presumption is that a threat of entry (either *de novo* or by acquiring a small "toe-hold" firm) could, premerger, have induced pricing restraint on the part of the large firms. As stated in *United States v. Marine Bancorporation*,¹⁵⁵ the inquiry relates to "the probability that the acquiring firm prompted premerger procompetitive effects within the target market by being perceived by the existing firms in that market as likely to enter *de novo*."¹⁵⁶ The Court set out three criteria for application of the doctrine: (a) the target market is "substantially concentrated;"¹⁵⁷ (b) the acquiring firm is a "perceived potential *de novo* entrant;" and (c) the presence of the acquiring firm "in fact tempered . . . behavior" of firms in the target market.¹⁵⁸

A related, but distinct, theory focuses on potential *future actual* competition. Unlike the "perceived" competition discussed above, which has a *present* effect on the market even if there is no *actual* entry, this theory applies where one firm would likely have entered the concentrated market (again, *de novo* or by small toe-hold firm¹⁵⁹) in the *future* had it not been acquired.¹⁶⁰ In *Marine Bancorporation*, the Court reserved judgment on the validity of this theory, but stated that if it were to apply, there must be (a) proof that there were feasible means to enter the market, and (b) a substantial likelihood that such entry would somewhat deconcentrate the market.¹⁶¹

The Merger Guidelines recognize both types of potential competition, but evaluate them under a single standard.¹⁶² The Department of Justice is

155. 418 U.S. 602, 624 (1974).

156. See also *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 174 (1964) ("the existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated"); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531-32 (1973) ("suspect also is the acquisition by a company not competing in the market but so situated as to be a potential competitor and likely to exercise substantial influence on market behavior").

157. In *Marine Bancorporation*, the three leading firms controlled 92% of the market. *Marine Bancorporation*, 418 U.S. at 630-31.

158. *Id.* at 624-25.

159. "In a highly concentrated, sluggish market, the acquisition of a small industry member by a powerful, innovative firm, by building upon the base of the smaller firm, can pose a more effective competitive challenge to the industry giants. Such procompetitive mergers are not only not forbidden by Section 7, they are positively encouraged." *Budd Co.*, 86 F.T.C. 518, 582 (1975). See generally Note, *Toehold Acquisitions and the Potential Competition Doctrine*, 40 U. CHI. L. REV. 156 (1972).

160. The theory was employed in *Kennecott Copper Corp. v. FTC*, 467 F.2d 67 (10th Cir. 1972), where one of the firms was found to be a substantial competitive force that was almost certain to enter the target market.

161. *Marine Bancorporation*, 418 U.S. at 633. The FTC has described the doctrine as a "rather peculiar theory of competitive injury" because of its focus on injury to competition due to the merger's causing a future nonevent (the inability of the acquiring firm to enter the market). *B.A.T. Industries*, 104 F.T.C. 852, 919-20 (1984). Similarly, Dean Rahl has characterized it as: "The competition lessened is competition which did not exist, but which was 'potential' in the sense that it is competition which the firm in question might have created itself." Rahl, *Applicability of the Clayton Act to Potential Competition*, 12 A.B.A. SEC. ANTITRUST L. 128, 142-43 (1958).

162. Merger Guidelines, *supra* note 43, § 4.13, at 26,834.

“unlikely” to challenge a merger under either theory if (a) the HHI in the acquired firm’s market is less than 1800, (b) new entry can be initiated without possessing certain unique “advantages,” or those advantages are possessed by three or more firms, and (c) the acquired firm has a 5% or less market share.¹⁶³

There are two other accepted bases for challenging a conglomerate merger. The first, called the “entrenchment” theory, holds that where a leading firm is acquired by a powerful firm in another market, the powerful firm may confer substantial advantages on the leading firm’s market presence, and thus serve to “entrench” the leading firm’s position.¹⁶⁴ The other theory, involving “reciprocal dealing,” is operative where one of the firms has unique abilities (such as purchasing power) to pressure market participants to buy products from the other firm.¹⁶⁵

The administrative law judge in *Southern California Edison* found the merger to have non-horizontal aspects that could harm potential competition. The judge found there to be a geographic market extension, where Edison and SDG&E competed in different, adjacent geographic markets for the sale of wholesale generating capacity.¹⁶⁶ “[R]ather than compete with SDG&E by offering lower rates and efficient and reliable service, Edison is entering the market by absorbing its only potential competitor.”¹⁶⁷ The judge also found there to be geographic market extension in the transmission service market. He found that by obtaining SDG&E’s rights in transmission corridors in which Edison was not a participant, Edison was entering a new “geographic market by means of stock trading rather than pro-competitive strategies.”¹⁶⁸

IV. RECENT ELECTRIC UTILITY MERGER APPLICATIONS AT THE FERC

The following is a description of the three recent merger hearings held at the FERC, PP&L/UP&L, Edison/SDG&E, and NU/PSNH and a discussion of other proceedings just now in their infancy.¹⁶⁹

A. *The PacifiCorp/Utah Power & Light Merger*

The principal source of concern in *Utah Power & Light* was the combination of PP&L’s control of excess generating capacity and UP&L’s control of

163. Merger Guidelines, *supra* note 43, §§ 4.131-134, at 26,834-35.

164. The leading case under this theory is *FTC v. Proctor & Gamble Co.*, 386 U.S. 568 (1967).

165. A violation of this sort was upheld in *FTC v. Consolidated Foods*, 380 U.S. 592 (1965), where one of the merging companies was a major customer of certain firms who were, in turn, potential purchasers of the other merging firm. Reciprocity is “an alleged tendency for prospective suppliers of a firm to direct their purchases to that firm in order to maintain its goodwill.” *United States v. White Consol. Indus., Inc.*, 323 F. Supp. 1397, 1398 (N.D. Ohio, E.D. 1971); *see also Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506, 518-19 (3d Cir. 1969), *cert. denied*, 396 U.S. 1009 (1970).

166. *See Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014, at 65,106-07 (1990) (decision of administrative law judge).

167. *Id.* at 65,107.

168. *Id.*

169. The issue of the effect of a merger on costs and rates, that is, whether on balance the merger will lower rates or not, is not addressed in any detail here.

bottleneck transmission facilities.¹⁷⁰ This was important because (a) utilities in the California and southern Nevada area were dependent in large part on expensive gas and oil-fired generation, and shopped actively for economy energy from the Northwest;¹⁷¹ (b) the Northwest possessed a heavy concentration of hydroelectric resources (which have the lowest marginal cost in the Western Systems Coordinating Council (WSCC)) and also a substantial supply of low marginal cost coal-fired generation;¹⁷² and (c) there were two primary transmission paths available for Southwest utilities to reach the Northwest, with one (an eastern corridor) controlled largely by UP&L, and the other (western corridor) composed of the Pacific Interties, controlled primarily by the Bonneville Power Administration (BPA).¹⁷³

The Commission found that UP&L's transmission facilities constituted "essential facilities"¹⁷⁴ in providing access to the Southwest and that, with the merger, PacifiCorp would have "enhanced ability to exercise monopoly power over transmission in the relevant geographic markets."¹⁷⁵ It accepted record evidence demonstrating that in the past UP&L had used its bottleneck facilities to refuse to wheel low cost power and extract monopoly profits.¹⁷⁶ Moreover, premerger, PP&L was unable to sell certain excess generating capacity because it was not competitively priced, but post-merger, PP&L could use UP&L's transmission facilities to preempt other competitors from selling to the Southwest. In addition, PacifiCorp could refuse to wheel the low cost power of other Northwest sellers, while "brokering" that power, that is, buying it and then reselling it in the Southwest at a markup. In either case, "where more expensive generation would displace cheaper generation there

170. PacifiCorp argued the merger was in the public interest because (a) it would produce efficiencies and lower costs to the companies' ratepayers, e.g., PP&L was a winter-peaking utility and UP&L was summer peaking; (b) the consolidation of resources and operations would allow for the elimination of overlaps and produce economies of scale; and (c) PP&L had excess generating capacity which it said could be used to defer future construction of generation by UP&L. Opinion No. 318, Utah Power & Light Co., 45 F.E.R.C. ¶ 61,095, at 61,269 (1988).

171. The FERC defined the Southwest, for these purposes, as California, southern Nevada, and the Desert Southwest. *Id.* at 61,285.

172. *Id.* n.120.

173. *Id.* at 61,286. Access via the western corridor, the Commission found, was problematic, given "BPA's Intertie access policies that restrict the ability of utilities to engage in both firm and non-firm sales." *Id.*

174. Participants have sparred over the relevance of "essential facilities" in a utility merger proceeding. Compare Post-Hearing Reply Brief of Pasadena at 21-24, FERC No. EC89-5-000 (essential facility relevant where merger causes foreclosure) with Post Hearing Brief of Applicants at 87-94, FERC No. EC89-5-000 (existence of essential facility does not affect merger analysis). For a discussion of the essential facilities doctrine, see Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841 (1990); Gorinson, *Overview: Essential Facilities and Regulation*, 58 ANTITRUST L.J. 871 (1990); Owen, *Determining Optimal Access to Regulated Essential Facilities*, 58 ANTITRUST L.J. 887 (1990); Ratner, *Should There Be An Essential Facilities Doctrine?*, 21 U.C. DAVIS L. REV. 327 (1988); Tye, *Competitive Access: A Comparative Industry Approach to the Essential Facility Doctrine*, 8 ENERGY L.J. 337 (1987); Werden, *The Law and Economics of the Essential Facility Doctrine*, 32 ST. LOUIS U.L.J. 433 (1987).

175. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,287.

176. *Id.* UP&L had previously engaged in inefficient use of its excess generation, and had expressed the need to "use up" its excess transmission for fear that "deregulation" would open it up to competing suppliers of generation. *Id.* at 61,289.

will be a loss of economic efficiency.”¹⁷⁷

As a remedy, the FERC conditioned the merger on the provision by PacifiCorp of transmission access to other utilities in the WSCC. The Commission reversed the presiding judge, who had denied the merger outright, finding that the Commission lacked authority to impose substantial remedial conditions. The judge had argued that section 203 conditioning power could be used only to “fine tune” an otherwise acceptable proposal, but could not function as a “meat axe in order to transmogrify a statutorily unacceptable proposal into one that meets the public interest.”¹⁷⁸

The Commission disagreed, finding it had “broad authority . . . to condition approval of a merger that would not, but for such conditions, be consistent with the public interest.”¹⁷⁹ The Commission noted earlier decisions appearing to restrict its conditioning power,¹⁸⁰ and found that while an “order requiring wheeling, without more, is impermissible since it would impose common-carrier status on the wheeling utility,” in this instance “the requirement that the merged company wheel power is based on our finding of likely anticompetitive effects of the merger.”¹⁸¹

The conditions ordered by the Commission have been widely reported and may be briefly summarized.¹⁸² In the first five years following the merger, PacifiCorp must make available all of its “remaining existing capacity”¹⁸³ on its transmission system for firm service to other utilities. This capacity will be allocated by the company on the basis of a formula providing that “transmis-

177. *Id.* at 61,289.

178. *Utah Power & Light Co.*, 43 F.E.R.C. ¶ 63,030, at 65,354 (1988).

179. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,282.

180. See *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *Richmond Power & Light Co. v. FERC*, 574 F.2d 610 (D.C. Cir. 1978); *New York State Elec. & Gas Corp. v. FERC*, 638 F.2d 388 (2d Cir. 1980); *Florida Power and Light Co. v. FERC*, 660 F.2d 668 (5th Cir. 1981); *City of Pairs v. Kentucky Utils. Co.*, 41 F.P.C. 45 (1969); *Union Elec. Co.*, 25 F.E.R.C. ¶ 61,394 (1983); *Central Main Power Co.*, 55 F.P.C. 2477 (1976).

181. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,281. The Commission also found it had conditioning authority under § 203(b) of the Act, which addresses the maintenance of adequate service and the coordination of facilities. *Id.* at 61,282. It held, “If we were to approve the merger without such conditions, utilities that compete with the merged company could be denied access to the merged company’s strategically located transmission facilities. This, in turn, could affect the coordination of jurisdictional facilities.” *Id.*

182. The company accepted the conditions. It stated that “a careful examination of the actual conditions crafted as a remedy to the FERC’s perceived concerns with the merger shows that the bulk of the Merger benefits are not affected by the order and that the effects on benefits are not large.” Interview with U.R. Topham, *reprinted in* *ELECTRICITY J.*, Dec. 1988, at 22. The conditions were, of course, controversial to others. A group of IOUs sent a telegram warning their brethren the *Utah Power & Light* opinion “would turn our transmission systems over to public power and others at the expense of our customers and hurt system reliability.” *Id.* at 25. The public power trade association shot back a stinging response to the IOU group, stating that “[u]nless these companies are abusing their monopoly control over transmission, the FERC order is of no consequence.” *Id.* In responding to the outcry, the Commission on rehearing stated, “[T]he transmission access conditions set forth in Opinion No. 318 are based on specific findings of fact . . . [They] are not intended as a generic approach to future merger proceedings, nor as a generic transmission access and pricing policy.” Opinion 318-A, *Utah Power & Light Co.*, 47 F.E.R.C. ¶ 61,209, at 61,733 (1989).

183. “Remaining existing capacity” was defined as “the difference between the merged company’s total transmission capacity and that capacity needed to serve both its native load customers and customers under firm contracts entered into prior to the merger application.” *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,291.

sion dependent utilities”¹⁸⁴ will receive 20%, nonaffiliated utilities interconnected with PacifiCorp on the north and east will get 30%, and all other utilities, including PacifiCorp, will receive the remainder. Service to the first two tiers must be provided at embedded costs, in a tariff to be filed after the merger. Rates for the last category will be “cost based,” but not limited to embedded costs.¹⁸⁵ The Commission limited the duty to wheel to other “utilities,” excluding PURPA-created entities (QF’s and small power producers) and retail wheeling to industrial customers. It also excluded non-firm wheeling.

The Commission imposed a long-term obligation on PacifiCorp to provide firm service “to any electric utility requesting it.”¹⁸⁶ This service must be provided at “cost-based rates,” which is “not intended to suggest rates that are limited to embedded cost,” but that “opportunity cost pricing as proposed by Applicants will not be permitted.”¹⁸⁷ The merged company must also build new transmission facilities if existing capacity is not available on its system. If the company fails to provide service within five years of a request, it will be required to reduce its own off-system transactions “to the extent necessary to meet all requests.”¹⁸⁸

B. *The Southern California Edison/San Diego Gas & Electric Merger*

The proposed merger between Edison and SDG&E carried with it some of the same corporate gamesmanship ordinarily witnessed in consolidations of nonregulated concerns.¹⁸⁹ SDG&E originally intended to merge with Tucson Electric Company, and had filed for FERC approval of such a merger. Soon thereafter, however, Edison launched an essentially hostile bid to wrest SDG&E away from Tucson Electric. Edison made an unsolicited offer to purchase SDG&E and began purchasing portions of SDG&E stock and requesting access to its shareholder lists.¹⁹⁰ SDG&E filed a complaint with the FERC, alleging that these purchases constituted *de facto* “acquisitions” without FERC approval.¹⁹¹ After further, higher offers, SDG&E’s Board of Directors reconsidered, and decided to accept the Edison offer.¹⁹² The pro-

184. “TDU” was defined as “those utilities that are dependent on the merged company for transmission access to their load or resources.” *Id.* n.165.

185. *Id.* at 61,292.

186. *Id.* at 61,294.

187. *Id.* at 61,291 n.163.

188. *Id.* at 61,294. Because the merging entities agreed to accept the conditions, on appeal to the D.C. Circuit no party has questioned the FERC’s authority to condition a merger on provision of transmission access. The issues on appeal are the FERC’s decision (1) not to mandate nonfirm wheeling, (2) not to require wheeling to QF’s and small power producers, (3) not to require retail wheeling to industrial customers, and (4) to limit the wheeling to entities predating the merger. Appeal Pending, *Environmental Action Inc. v. FERC*, No. 89-1333 (D.C. Cir.).

189. “The ‘gentlemen’s club’ aspect of utility business, if it ever existed, seems largely a relic of the past.” Hawes, *supra* note 7, at 32.

190. “Apparently, the financial advisers to SDG&E were not able to opine that the price was inadequate and, absent such an opinion, the legal advisers were unable to advise that directors could, with impunity, ‘just say no.’” Hawes, *supra* note 9, at 11.

191. FERC Docket No. EL 89-1-000.

192. Some parties argued that SDG&E’s ultimate acquiescence was the result of coercion, and that the

posed merger would create, by some measures, the largest electric utility in the nation.

As in *Utah Power & Light*, a central focus in *Southern California Edison* was access to transmission. The transmission concerns centered on Edison and SDG&E ownership of substantial transmission capacity both to the Pacific Northwest and to the Desert Southwest. As discussed above, the Northwest contained cheap hydroelectric power, and in the Southwest there were several utilities awash in excess coal and nuclear generating capacity. Access to these resources, on both a long-term and economy energy basis, was extremely important to southern California public and private utilities. These utilities were heavily reliant on expensive gas and oil-fired generation, and given their highly populated service area, already burdened with severe pollution problems, they found the construction of additional generating facilities extremely difficult. Both Edison and SDG&E owned substantial entitlements on the large extra-high voltage (EHV) lines running to these two resource-rich regions.

A thorny issue not present in *UP&L* was the role of Edison's unregulated affiliate, Mission Energy. As indicated, certain intervenors alleged that Mission sold QF power to Edison at marked up prices and that the merger would extend such "self dealing" to capacity-deficient SDG&E.¹⁹³

Perhaps the wildcard in this merger was the unalterable opposition of the City of San Diego to Edison's swallowing up its local utility. Though SDG&E had not always been particularly popular with local residents (partly as a result of constantly rising utility rates in the 1970s and early 80s), the sudden loss of a locally headquartered, independently managed utility altered the political landscape.¹⁹⁴ The City presented a formidable case at the FERC and at the CPUC opposing the merger, and even authorized a local entity to study the possibility of municipalization.

The FERC judge denied the merger outright. The judge found the merger to be anticompetitive in all identified markets, found there to be a substantial possibility of evasion of rate regulation through SCEcorp's unregulated subsidiary Mission Energy, and found there to be insufficient evidence of counterbalancing efficiencies.¹⁹⁵ The judge found the merger so anticompetitive that as a "practical matter" the Commission could not "condition" the

issue should be set for hearing. The FERC disagreed, stating that: "The fact that San Diego initially resisted Edison's merger proposal and, after apparently hard and successful bargaining, accepted an improved merger proposal does not, in our opinion, present any evidence that San Diego was somehow forced into accepting Edison's offer. San Diego is a large, financially sound corporation, capable of bargaining with another large utility." *Southern Cal. Edison Co.*, 47 F.E.R.C. ¶ 61,196, at 61,676 (1989). "If one can conclude anything from the tone of the Edison/San Diego order, it appears that FERC is simply not disposed to play referee in the rough and tumble corporate takeover world." Williams, *supra* note 15, at 19.

193. See *Edison*, 47 F.E.R.C. ¶ 61,196, at 61,666.

194. "The California PUC proceeding has had virtually every issue that could be imagined and has been played against a background of City rivalry (San Diego versus L.A.), a gubernatorial election, an earthquake in Northern California, and a quasi war with Iraq." Hawes, *supra* note 7, at 13.

195. *Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014 (1990).

marketplace to ensure the merged company would act in the public interest.¹⁹⁶ Thus, the “imposition of wheeling or access conditions . . . would constitute a needless and unproductive endeavor.”¹⁹⁷ In rather broadly styled concluding remarks, the judge argued: “Conditions attached to merger authorizations increase regulatory intervention in the marketplace and result in greater costs to society.”

C. *The Northeast Utilities/Public Service of New Hampshire Merger*

The merger between NU and PSNH represented perhaps the final chapter in the saga of the Seabrook nuclear plant. The troubled plant was delayed in its construction and operation by intense opposition from environmental and anti-nuclear groups. These delays contributed to the utility's deteriorating financial picture. Finally, in late 1988, PSNH filed for protection from its creditors under the federal bankruptcy laws, the first major electric utility to do so in fifty years. The merger was consummated under the umbrella of the bankruptcy court reorganization proceedings, and the agreements were negotiated by NU and the State of New Hampshire. The Commission vowed not to be blind to these circumstances in fashioning whatever conditions it might impose.¹⁹⁸

The existence of the New England Power Pool (NEPOOL) also made the merger unique.¹⁹⁹ NEPOOL was formed by New England utilities as a cooperative body, with its basic function to centrally dispatch the systems on a least cost basis.²⁰⁰ Other important functions included the planning of jointly owned generation facilities, load forecasting, and other planning. The Commission, in its hearing order, asked: “Are any changes induced by the merger likely to degrade the performance of NEPOOL or is the NEPOOL Agreement robust enough to deal with such changes easily?”²⁰¹

The transmission debate centered around arguments that the combination of NU and PSNH would create a transmission “curtain,” sealing off eastern Massachusetts and Rhode Island utilities from sources of supply in Maine, Vermont, Canada, and New York. The fact that utilities in New England were projected to be in a tight capacity situation in the late 1990s heightened the concern that the merged company would be in a position to use its transmission dominance to sell its surplus generating capacity at above market prices.

The presiding judge approved the merger, finding that PSNH's “success-

196. *Id.* at 65,100.

197. *Id.* at 65,147.

198. *See* Northeast Utils. Serv. Co., 50 F.E.R.C. ¶ 61,266, at 61,830 (1990); *see also* Northeast Utils. Serv. Co., 51 F.E.R.C. ¶ 61,177, at 61,486 (1990).

199. “Since no region-wide power pool exists within the WSCC, the strategic dominance of the merged company over transmission could interfere with the coordination of jurisdictional facilities by handicapping the operation of a well-functioning bulk power market.” Utah Power & Light Co., 45 F.E.R.C. ¶ 61,095, at 61,283 (1988).

200. “[NEPOOL] has fostered reliable and efficient centralized bulk power operations over a multi-company six-state area for years.” Northeast Utils. Serv. Co., 53 F.E.R.C. ¶ 63,020 at 65,214 (1990) (initial decision).

201. *Northeast Utils.*, 50 F.E.R.C. ¶ 61,266, at 61,835.

ful reorganization is unquestionably in the public interest”²⁰² and that “PSNH’s ability to survive alone is doubtful.”²⁰³ The judge imposed certain wheeling conditions, however, ruling that “[u]tilities in Eastern REMVEC will be surrounded by territory of the merged company, and completely dependent upon it to get electricity from other places.”²⁰⁴ The judge required the company to provide wheeling to all utilities under a twenty-year tariff at embedded cost rates for existing capacity but left open the ability of NU to charge incremental cost rates for newly constructed transmission facilities.²⁰⁵ In a hotly contested issue, the judge rejected calls to abolish the native load priority for use of NU’s transmission system, finding that “[t]here is no legal requirement that a utility equalize its native load customers with all others.”²⁰⁶

D. *KG&E, KCP&L & KPL: Three’s Company?*

The drama of which utility could gain ownership of Kansas Gas & Electric was one of the most interesting developments of 1990. It was also destined to be precedent-setting.

Kansas City Power & Light (KCP&L) launched a hostile bid to acquire a reluctant KG&E, hoping to circumvent the KG&E board by obtaining 90% shareholder approval and thus effecting a short-form merger.²⁰⁷ KCP&L, undaunted by KG&E’s opposition, filed for FERC approval of the merger prior to obtaining the necessary shares. It even sought to bypass a hearing altogether by offering open transmission access on the condition that the FERC not hold a hearing.²⁰⁸ KG&E opposed the application, arguing that the Commission was without authority to approve a merger “in the absence of an agreement between buyer and seller,” but conceded it was a case of “first impression.”²⁰⁹ KG&E also opposed expedited consideration of the merger, if set for hearing, on the basis that a fast track would give KCP&L the upper hand, scaring away a potential white knight.²¹⁰

The Commission rejected KG&E’s pleas, finding that “an acquiree’s opposition to a proposed merger *in and of itself* is not enough to cause us to look unfavorably upon an applicant’s request for section 203 approval.”²¹¹ Commissioner Trabandt, concurring, agreed that the Commission should not “require the assent of the target board before opening a hearing under section 203.”²¹² But, believing that the KCP&L bid was far from victory, and that a white knight had been sighted, the Commissioner warned that by granting a hearing the FERC could “create a three ring mess, if not a regulatory

202. *Northeast Utils.*, 53 F.E.R.C. ¶ 63,020, at 25,211.

203. *Id.*

204. *Id.* at 65,215.

205. *Id.* at 65,222-24.

206. *Id.* at 65,222.

207. *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097, at 61,273 n.3 (1990).

208. *Id.* at 61,276.

209. *Id.* at 61,278 & n.49.

210. *Id.* at 61,278.

211. *Id.* at 61,283 (emphasis in original).

212. *Id.* at 61,293 (Trabandt, Comm’r, concurring).

circus.”²¹³

Before long, this possibility became reality, as Kansas Power & Light (KP&L) appeared as a white knight, with a higher offer, and won KG&E's affection. This threw the hearing on KCP&L's application into confusion, when KG&E promptly asked the administrative law judge to suspend the hearing in light of the new development. The judge rejected this request, finding that it was in the realm of possibility that KCP&L may still succeed in its offer.²¹⁴

Soon thereafter, however, the threesome collapsed as KCP&L withdrew its bid. Claiming that it had been denied essential financial information needed to match or beat the KPL offer, KCP&L vowed not to stray too far, saving the possibility that a subsequent offer could be launched at a later date.

E. The PacifiCorp/APS Agreements: A De Facto Merger?

Shortly after it acquired UP&L, PacifiCorp turned its sights to Pinnacle West and its Arizona Public Service subsidiary. For almost a year, PacifiCorp pursued an unfriendly bid to acquire APS. Both sides traded barbs in the trade press, with PacifiCorp maligning Pinnacle West's already maligned management, and APS warning local ratepayers of the loss of local control.

The feud finally ended with a settlement characterized as a “power sharing” agreement. The agreement provided for the sale of a generating unit, a swap of transmission services, and an exchange of power.²¹⁵ Not much time passed, however, before intervening parties were calling the agreements a “*de facto*” merger. Several utilities voiced opposition to unconditional approval of the agreements and asked the FERC to hold a hearing on whether section 203-style transmission access conditions were warranted.

The company shot back that “[t]he intervenors' objectives are clear—they wish to enhance their transmission opportunities . . . [and] see this proceeding as an opportunity to leverage an improved competitive position in bulk power markets.”²¹⁶ PacifiCorp argued that the transaction was styled so that there was no disposition or merger of jurisdictional facilities, i.e., transmission, and thus no section 203-type conditions were permissible. The FERC recently decided not to set the case for hearing.

F. Midwest Energy/Iowa Resources: A Section 203 Exception for Utility Holding Company Mergers?

Recently, a rather unexpected, but potentially important, section 203 “loophole” was litigated. In *Missouri Basin Municipal Power Agency v. Midwest Energy Co.*, the FERC considered a complaint by a municipal customer group that the merger of Midwest Energy Company (Midwest) and Iowa

213. *Id.* at 61,292 (Trabandt, Comm'r, concurring).

214. Kansas City Power & Light Co., No. EC90-16-000, slip op. (F.E.R.C. Nov. 9, 1990). The KP&L/KG&E merger application was recently set for hearing. Kansas Power & Light Co., 54 F.E.R.C. ¶ 61,077 (1991).

215. PacifiCorp Elec. Operations, ER91-26-000 (F.E.R.C. Oct. 12, 1990).

216. Answer of PacifiCorp to Motions to Intervene at 18-19, No. ER91-26-000 (F.E.R.C. Nov. 16, 1990).

Resources, Inc. (Iowa Resources), two utility holding companies, was proceeding without prior Commission approval.²¹⁷ The merging entities defended their failure to seek FERC approval on the basis that neither entity was a "public utility" operating jurisdictional assets, but rather that both were merely holding companies²¹⁸ and thus not subject to section 203 approval.²¹⁹ Missouri Basin argued that the Commission should focus on the "substance" of the merger rather than the corporate form and pointed out that the companies' SEC filings had indicated that joint dispatch and coordination of the subsidiary public utilities' operations were planned.²²⁰

The Commission summarily dismissed the complaint, holding that the "Commission historically has declined to classify public utility holding companies as public utilities" and that "[t]o classify such holding companies as public utilities in these circumstances would be inconsistent with the distinct statutory definitions provided by Congress."²²¹ The Commission found that the "coordination" contemplated in the companies' SEC filings "does not *ipso facto* constitute a merger or consolidation of jurisdictional facilities." The Commission did not appear to be concerned with the argument that once the holding company merger had proceeded, a later merger of operating subsidiaries could be more difficult to review. The Commission simply stated that any future merger or consolidation of jurisdictional facilities would require prior Commission approval.²²²

V. THE TASK AHEAD: ANSWERING THE UNANSWERED QUESTIONS

The following is a series of questions, the answers to which, for the most part, remain quite fuzzy. The list is not exclusive. These are, perhaps, among the most important questions in need of resolution.

A. The "Public Interest" Test: How Broad Is It?

Section 203 contains the command that the Commission shall approve a merger if it finds it "consistent with the public interest."²²³ The question is, what does "public interest" include? As one might guess, there are no definitive answers. A few things, however, can be said with some certainty.

First, it is well established that the Commission generally will focus on six "nonexclusive" issues: (1) the effect on operating costs and rate levels; (2) the accounting treatment; (3) the reasonableness of the purchase price; (4) whether the merger was the result of coercion; (5) whether it will harm competition; and (6) whether it will impair effective state or federal regula-

217. *Missouri Basin Mun. Power Agency v. Midwest Energy Co.*, 53 F.E.R.C. ¶ 61,368 (1990).

218. Midwest owned 100% of the common stock of Iowa Public Service Co., and Iowa Resources owned 100% of the common stock of Iowa Power, Inc. *Id.* at 62,295-96.

219. Section 203 applies only to "public utilities." 16 U.S.C. § 824b(a) (1988).

220. *Missouri Basin*, 53 F.E.R.C. ¶ 61,368, at 62,297.

221. *Id.* at 62,298.

222. *Id.* at 62,299. Since the Commission found it had no jurisdiction over the merger, it declined to address the issue of whether a § 318 conflict existed between the FERC and the SEC. *Id.*

223. 16 U.S.C. § 824b.

tion.²²⁴ These are commonly referred to as the “*Commonwealth*” factors, named after the case first enunciating them.²²⁵

One issue was settled quickly after enactment of the Federal Power Act (FPA). In 1940, the Ninth Circuit in *Pacific Power & Light Co. v. FPC* reversed a Commission decision that had rejected a merger on the ground that it did not produce “any substantial advantage or benefit to the public.”²²⁶ The Ninth Circuit held that “consistency” with the public interest “does not connote a public benefit to be derived or suggest the idea of a promotion of the public interest.”²²⁷ Section 203 “does not require a showing that positive benefit to the public will result;”²²⁸ rather, “compatibility” with the public interest is all that is required.²²⁹

On the important issue of the merger’s effect on competition, the D.C. Circuit held in *Kansas Power & Light Co. v. FPC* that “[t]he Commission has, of course, an obligation under the Federal Power Act to consider antitrust policies in determining whether a merger satisfies section 203’s ‘public interest’ standard.”²³⁰ The court of appeals relied, in part, on *Gulf States Utilities Co. v. FPC*,²³¹ which had held that the Commission must consider antitrust allegations when determining whether a securities issuance is “compatible with the public interest.”²³² “Consideration of antitrust and anticompetitive issues by the Commission . . . serves the important function of establishing a first line of defense against those competitive practices that might later be the subject of antitrust proceedings.”²³³

In *Commonwealth*, the Commission held that it should address a minimum of three questions regarding the effect on competition:

- (1) will the merger bring a significant added concentration of economic power?
- (2) will it eliminate any meaningful competition which may exist, either directly or by example, in attracting new industries to their respective service areas, in making wholesale sales, or in providing economical service?
- (3) will it have an

224. *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,279 (1988). In *Utah Power & Light*, the Commission set for hearing the effect on costs and rates, competitive issues, and impairment of regulation. *Id.* In *Southern California Edison*, the Commission set for hearing the issue of costs and rates, the competitive situation, and the purchase price (to the extent that it affected costs and rates). *Southern Cal. Edison Co.*, 47 F.E.R.C. ¶ 61,196, at 61,672-73 (1989). In *Northeast Utilities*, the Commission set for hearing the effect on competition and cost and rate levels. *Northeast Utils. Serv. Co.*, 50 F.E.R.C. ¶ 61,266, at 61,834-36 (1990).

225. Opinion No. 507, *Commonwealth Edison Co.*, 36 F.P.C. 927 (1966).

226. *Pacific Power & Light Co. v. FPC*, 111 F.2d 1014, 1016 (1940).

227. *Id.* at 1016.

228. *Id.* at 1017.

229. *Id.* at 1016. Continuing, the court said § 203 “does not disclose a policy hostile to all such mergers or indicate that Congress looked upon them as presumptively harmful. We see no more in the prohibition than the purpose of insuring against public disadvantage through the requirement of a showing that mergers of this sort will not result in detriment to consumers or investors or to other legitimate national interests.” *Id.*

230. *Kansas Power & Light Co. v. FPC*, 554 F.2d 1178, 1184 (D.C. Cir. 1977).

231. 411 U.S. 747 (1973).

232. 16 U.S.C. § 824c sets forth the provisions regarding approval of the issuance of securities.

233. *Gulf States*, 411 U.S. at 760. “The Act was passed in the context of, and in response to, great concentrations of economic and even political power vested in power trusts, and the absence of antitrust enforcement to restrain the growth and practices of public utility holding companies.” *Id.* at 758.

adverse effect on competing energy sources?²³⁴

In a statement echoing antitrust decisions of that era, the Commission said, "There is a legitimate public interest in the degree of concentration of economic power in American industries and, notwithstanding the safeguard of regulation, even in the electric utility industry."²³⁵

Commonwealth's discussion of the competition issue has not been repeated by the Commission in its recent opinions.²³⁶ In *Utah Power & Light*, the Commission provided a brief, common sense explication of the "public interest" standard. It stated that "the Commission is not strictly bound by . . . the antitrust laws; they are employed to give understandable content to the broad statutory concept of the public interest."²³⁷ Continuing, the Commission stated that it would "weigh" its antitrust findings "along with other important public interest considerations."²³⁸

There is no more complete definition to date, although in subsequent merger cases, the Commission has sought to provide more detailed advice to the parties on specific competition issues. For example, in *Kansas City Power & Light Co.*, the Commission provided fairly specific instructions on the determination of product and geographic markets, the relevance of measures of market concentration, and the effect of transmission conditions on market power.²³⁹

B. Commission Authority to Order Wheeling: Is a Nexus between Remedy and Injury to Competition Required?

After *Utah Power & Light*, the extent of the Commission's authority to order wheeling under section 203 was hotly debated. One central question was whether there must be a "nexus" between the harm to competition (injury) and the type of wheeling ordered by the Commission (remedy).

The FERC made several remarks in *Utah Power & Light* suggesting that some degree of nexus is required. It held that an "order requiring wheeling, *without more*, is impermissible since it would impose common-carrier status on the wheeling utility" but that it could order wheeling "based on our finding of likely anticompetitive effects."²⁴⁰ The wheeling conditions it imposed were the "minimum necessary" to do the job,²⁴¹ and were "specifically tailored" to

234. Opinion No. 507, *Commonwealth Edison Co.*, 36 F.P.C. 927, at 941 (1966).

235. *Id.* On the facts before it, the FPC concluded that, although antitrust law was "relevant," it offered "limited guidance" because the utilities in issue were "not in direct competition with each other in the major arena of their activities, namely, their sales to ultimate consumers" and because regulation "operates as a powerful constraint on the possible abuse of monopolistic power by public utilities." *Id.* at 940-41.

236. "The scope of the Commission's review . . . has grown from three questions in *Commonwealth Edison* to an extensive Clayton Act, Section 7 type of analysis . . ." Williams, *supra* note 15, at 23.

237. Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,283 (1988).

238. *Id.*

239. *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097, at 61,286-88 (1990).

240. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,281 (emphasis added). A finding of anticompetitive effects that could be cured by wheeling "is the essential predicate to exercise of the broad wheeling power that the Commission now asserts under Section 203 of the Federal Power Act." Williams, *supra* note 15, at 26.

241. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,289-90.

remedy the anticompetitive effects of the merger.²⁴² The Commission found that it had "broad authority" under section 203(a) to condition a merger that "but for" such conditions would not be consistent with the public interest.²⁴³ It also noted its authority under section 203(b) to impose conditions necessary to maintain "adequate service" and "coordination."²⁴⁴

Commissioner Trabandt, in a separate opinion, spoke of the "prolonged debate" on the "fundamental purpose and scope" of the Commission's authority to order wheeling under section 203.²⁴⁵ He advocated a "direct nexus between the form and substance of the condition . . . and the prospective adverse effect" on competition.²⁴⁶ Noting the Commission's relative inability to order wheeling in other contexts, he argued that a direct nexus test is not only good policy, but is the "absolutely mandatory legal predicate for the Commission's authority to impose a transmission access condition of any kind."²⁴⁷ In his usual colorful style, the Commissioner said section 203 does not permit "an unconstrained fishing expedition for anti-competitive activity or a virtual witch hunt for past anti-competitive behavior."²⁴⁸

In *Southern California Edison*, the Commission requested the parties to address what conditions would be "necessary" to eliminate any adverse impacts of the merger.²⁴⁹ The FERC staff recommended conditions for only a subset of parties (namely transmission dependent cities surrounded by Edison). This limitation was appropriate, the staff's economist argued, because "[c]onditions that would impose costs on the entire market should not be imposed in order to solve the particular problems of a small part of the market."²⁵⁰ The judge declined to impose conditions, and thus had no occasion to address this issue.

One divisive issue in *Northeast Utilities* was a proposal by certain intervenors to have the FERC adopt a "regional" transmission agreement as a condition of the merger, requiring all NEPOOL utilities to provide wheeling. The applicants and New Hampshire and Connecticut opposed it, arguing, in part, that such a region-wide "fix" could only be accomplished by amending the NEPOOL agreement, and thus was beyond the FERC's authority in the merger proceeding. The judge agreed, finding that "[t]his merger proceeding is not (and cannot be) the vehicle for actually adopting a regional transmission

242. Opinion No. 318-A, *Utah Power & Light Co.*, 47 F.E.R.C. ¶ 61,209, at 61,733 (1989).

243. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,282.

244. *Id.*

245. *Utah*, 47 F.E.R.C. ¶ 61,209, at 61,756 (Trabandt, Comm'r, dissenting in part).

246. *Id.* at 61,759. In *Ford Motor Co. v. United States*, the Court rejected "the suggestion that antitrust violators may not be required to do more than return the market to the *status quo ante*." *Ford Motor Co. v. United States*, 405 U.S. 562, 573 n.8 (1972). The Court referred to an earlier case where it had "sustained broad injunctions regulating motion picture licenses and clearances which were not related to the *status quo ante*." *Id.* It concluded that relief under the Clayton Act "is not limited to the restoration of the *status quo ante*. Rather, the relief must be directed to that which is necessary and appropriate in the public interest to eliminate the effects of the acquisition offensive to the statute." *Id.* (emphasis in original).

247. *Utah*, 47 F.E.R.C. ¶ 61,209, at 61,759 (Trabandt, Comm'r, dissenting in part).

248. *Id.* at 61,758.

249. *Southern Cal. Edison Co.*, 47 F.E.R.C. ¶ 61,196, at 61,675 (1989).

250. Ex. 809 at 14, No. EC89-5-000 (F.E.R.C.).

agreement.”²⁵¹

The presiding judge declined to adopt many of the conditions proposed by intervenors and the staff. He focused instead on NU’s proposed wheeling tariff and any necessary modifications thereto. “If the finished product—the NU-PSNH merger, with the ‘proposed’ Commitments as modified—is consistent with the public interest, that is the end of the matter. Whether some other plan might be ‘better’ from a customer’s viewpoint is of no significance.”²⁵² The judge rejected many conditions as unrelated to the merger, citing *Southern Pacific Transportation Co.*, an ICC merger case, which held that “conditions on a merger are not to be used to ameliorate long-standing problems which were not created by the merger.”²⁵³

C. *Transmission Priority: Who Comes First?*

Once the FERC has crossed the threshold of ordering wheeling and opening up the merging companies’ transmission systems to competitors, the issue is which entities should be first in line for available capacity? The debate most often breaks out between the transmission owner, purchasing for its “native load,”²⁵⁴ and various categories of wheeling customers.²⁵⁵

In *Utah Power & Light*, the Commission recognized several categories of priority, both native load and as between various competitors. In the short term (for the five years following the merger), the Commission allowed PacifiCorp to reserve “that capacity needed to serve both its native load customers and customers under firm contracts entered into prior to the merger application.”²⁵⁶ The Commission designated three tiers of competitors in the queue for the capacity remaining: TDU’s (receiving 20% of the remaining capacity); competing utilities to the north and east of PacifiCorp (receiving 30%) (presumably those competing for sales to the Southwest); and lastly, all other utilities sharing in the remaining 50%.²⁵⁷ A native load priority was also maintained in PacifiCorp’s long-term obligation to provide wheeling. The FERC ordered PacifiCorp to provide wheeling “unless the Company determines that provision of the requested service would impair its ability to render firm service to native load customers.”²⁵⁸ In the event of a shortage, however,

251. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,229 (decision of administrative law judge).

252. *Id.* at 65,220.

253. *Southern Pac. Transp. Co. v. ICC*, 736 F.2d 708, 722 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1208 (1985).

254. “Native load” can be defined in varying ways, but generally may be described as a utility’s retail service customers and wholesale customers, full requirements or otherwise, which the utility includes in its planning process.

255. In the various industry proposals for transmission policy, investor-owned utilities have generally favored a priority for native load customers, while public power has sought, with some variations, equivalent treatment of wheeling customers and native load retail customers. See FERC TRANSMISSION TASK FORCE, *supra* note 10, at 154-55.

256. Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,291 (1988). The Commission staff’s witness on transmission conditions acknowledged that transmission capacity may not be available where it is “fully committed to other higher priority uses, either by law through service obligations to retail customers or by contract to wholesale customers.” Ex. 100 at 22, No. EC88-2-000 (F.E.R.C.).

257. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,291.

258. *Id.* at 61,311. Similarly, if transmission sold by PacifiCorp to other utilities were to be resold back

the company was required to "reduce its own off-system transactions"²⁵⁹ to meet wheeling requests.²⁶⁰

In *Southern California Edison*, the FERC staff proposed that TDUs²⁶¹ have a higher priority than other competitors of Edison. The staff recommended that Edison provide TDU's with wheeling upon request if feasible, and if not, to provide "alternative service arrangements of comparable value."²⁶² For other utilities, however, the staff recommended different terms, namely that Edison be required to provide wheeling service only "when such arrangements do not jeopardize, impair or adversely affect service to SCE's own customers."²⁶³ The judge did not undertake an examination of priorities, as he denied the merger outright.

In *Northeast Utilities*, the issue of a native load priority generated substantial controversy. The FERC staff's transmission witness advocated the abandonment of native load priority. The witness concluded that "giving preference to native load customers in making determinations of transmission adequacy and needs is an anticompetitive practice rather than a reasonable method for New England utilities that own transmission facilities to ensure service reliability for their native load customers in New England."²⁶⁴

The proposal generated a federal-state clash. The States of New Hampshire and Connecticut mobilized to combat it, and one well known state regulator testified for the states that staff's proposal "would put native load customers in jeopardy in a constrained transmission circumstance and that would be unacceptable to state regulators."²⁶⁵ He concluded that removal of such a priority would be "too draconian, too intrusive and too extreme to be warranted," and likely would be "self-defeating" in that it would provide disincentives for the affected states in considering whether to approve construction of new transmission facilities to meet wheeling requests.²⁶⁶

The judge rejected the calls to abolish native load priority. He noted that utilities' "very existences are linked to their obligation to serve native load

to PacifiCorp, PacifiCorp would be required to make that capacity available to other utilities, but only "to the extent that it is not needed to serve native load." *Id.* at 61,295.

259. The Commission excluded from this provision (1) off-system purchases by PacifiCorp to meet native load; and (2) firm contracts entered into prior to the merger. *Id.* at 61,294 n.172.

260. *Id.* at 61,294. This is colloquially referred to as the "Utah Hammer Clause." See *Northeast Utils. Serv. Co.*, 50 F.E.R.C. ¶ 61,266, at 61,844 (1990) (Trabandt, Comm'r, concurring).

261. The staff defined a "TDU" as "an entity that depends upon the network transmission facilities of the Merged Company in order to obtain transmission access to other Entities" Ex. 845 at 4, No. EC89-5-000 (F.E.R.C.).

262. Ex. 845 at 2, No. EC89-5-000 (F.E.R.C.).

263. Ex. 844 at 42, No. EC89-5-000 (F.E.R.C.). It should be kept in mind that the staff did not find the merger to be anticompetitive for non-TDUs, and thus the staff's differing treatment of non-TDUs should be evaluated in this context. The staff's witness supported Edison's obligation to build "incremental facilities" for non-TDUs but only if the expansion could "be installed, operated and maintained without adverse effect on the use of Edison's existing and planned (future) system to provide reliable and economical service to its retail and wholesale requirements customers." *Id.* at 45.

264. Ex. 601 at 4, No. EC90-10-000 (F.E.R.C.).

265. Ex. 228 at 13, No. EC90-10-000 (F.E.R.C.) (testimony of Ashley Brown, Commissioner, Ohio PUC).

266. *Id.* at 15.

customers,” and found that “[t]here is no legal requirement that a utility equalize its native load customers with all others.”²⁶⁷ Continuing, he found that *even if* the NU/PSNH transmission network were an essential facility, “that status would not warrant destroying native load preference.”²⁶⁸ “NU’s choice, to prefer native load when constraints are immutable, is fair, and it strikes a reasonable balance between conflicting interests.”²⁶⁹

D. Transmission Pricing: What Is Fair and What Is Efficient?

An integral component of any wheeling remedy is pricing. A finding of market power assumes that certain firms have the ability to maintain bulk power or transmission rates above competitive levels, or deny access to transmission entirely. Accordingly, any remedy must limit supracompetitive pricing.

In *Utah Power & Light*, PacifiCorp had argued that it should be permitted to charge for embedded costs plus lost economic benefits (opportunity costs).²⁷⁰ The FERC rejected this, and instead imposed transmission access at cost based rates. For the transitional five-year period, the FERC ordered that TDUs²⁷¹ and utilities connected to the north and eastern portions of PacifiCorp receive service at embedded costs.²⁷² For service to all other utilities, the company was allowed to charge “cost based” rates.²⁷³ The Commission defined “cost based” in the negative: it was not limited to embedded costs,²⁷⁴ nor was it to include opportunity costs.²⁷⁵

For long-term firm service, PacifiCorp was allowed to charge embedded system costs together with certain incremental costs “caused by the commitment” to provide service.²⁷⁶ The FERC held that “where additional capacity is needed to meet a request, rates may be designed to specifically assign the cost of that capacity addition to the party requesting service.”²⁷⁷

267. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,222 (1990) (decision of administrative law judge).

268. *Id.*

269. *Id.*

270. Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,290 (1988).

271. TDUs were defined as “those utilities that are dependent on the merged company for transmission access to their load or resources.” *Id.* at 61,291 n.165, 61,310.

272. *Id.* at 61,292.

273. *Id.*

274. The FERC staff’s witness testified that “open transmission access to the bulk power market at average embedded cost of service rates is not likely to result in efficient use of transmission resources in the region” and further, that “[t]he Commission should not, without careful consideration, simply extend embedded cost transmission pricing to entities not currently receiving it.” Ex. 100 at 9-10, No. EC88-2-000 (F.E.R.C.).

275. *Utah*, 45 F.E.R.C. ¶ 61,095 at 61,291 n.163.

276. *Id.* at 61,312.

277. *Id.* at 61,291 n.163. A UP&L official was quoted after the merger as saying it is “reasonably clear from the FERC order that the requesting party, after the five-year transition period, would be required to pay for the incremental cost of the transmission facilities.” *Reprinted in* *ELECTRICITY J.*, Dec. 1988, at 22, 24. The staff’s witness had argued that “[i]f the primary beneficiaries of any additional transmission capacity are other utilities, those utilities should bear most, if not all, of the financial burden.” Ex. 100 at 16, No. EC88-2-000 (F.E.R.C.).

The debate over “rolled in” embedded cost pricing versus “incremental” cost pricing for the construction of new facilities raged on after *Utah Power & Light*.²⁷⁸ Wheeling customers typically advocated rolled in pricing on the basis that (a) new construction additions benefit the entire transmission system, because systems are fully integrated (each part supports the others), and thus the cost of additions should be borne by all customers; and (b) wheeling customers, especially TDU’s, have paid their fair share in the past for use of the system and should not be treated as the incremental or “marginal” user. The wheeling utility has typically argued that incremental cost pricing is fair because (a) the incremental customer causes the need for the addition and thus should bear the cost burden (benefits/burdens); and (b) such pricing sends the appropriate “price signal,” allowing the wheeling customer to measure the costs of a particular purchase of delivered bulk power (including all necessary wheeling charges) versus a purchase that can be accommodated on an existing transmission network.²⁷⁹

In *Southern California Edison*, the Commission staff proposed a distinction in pricing between TDUs and non-TDUs. For TDUs, staff’s witness proposed that transmission should be based on “Edison’s costs for network transmission service.”²⁸⁰ He would have allowed “incremental cost” pricing to TDUs only in the circumstance of specifically identifiable transmission facilities for service to a new generating source.²⁸¹ On pricing of transmission for non-TDUs, however, the staff supported allowing Edison to charge for incremental costs of building new transmission facilities.²⁸² The judge did not impose conditions, and thus did not specifically address wheeling pricing.

In *Northeast Utilities*, the Commission in its hearing order asked: “To what extent, if any, will the price and non-price terms of the merged company’s transmission commitments effectively mitigate any potential additional market power in transmission and delivered bulk power markets obtained through the merger?”²⁸³ The FERC staff advocated that for the first five years following the merger, the cost of additional “network facilities” should be “rolled-in with NU’s other transmission costs” in setting the transmission

278. It should be noted that the Commission did not indicate that unregulated, market based transmission rates would be considered. The Commission’s Task Force had looked at deregulating transmission prices, finding that while regulated prices “tend to be inflexible and incapable of responding quickly to changes in market conditions,” that unregulated prices charged by a transmission owner with market power could result in monopoly pricing. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 104-05. The Task Force seemed to settle on the conclusion that flexibility in the pricing of non-firm transmission combined with assured long-term firm access at cost-based rates is the best solution. *Id.* at 116-20.

279. One author has argued that “where excess capacity exists, a wheeling rate based on embedded costs results in a wheeling rate which is too high and thereby discourages efficient generation trades and use of otherwise idle facilities Conversely, where the lines are near maximum capacity, an embedded cost rate yields a rate which is too low and encourages wheeling over a fully loaded system at a longer distance.” Wallace, *supra* note 14, at 113.

280. Ex. 845 at 2, No. EC89-5-000 (F.E.R.C.).

281. Ex. 1077, No. EC89-5-000 (F.E.R.C.).

282. Ex. 844 at 47, 50, No. EC89-5-000 (F.E.R.C.).

283. Northeast Utils. Serv. Co., 50 F.E.R.C. ¶ 61,266, at 61,835 (1990).

rate.²⁸⁴ However, the staff also left the door open for “alternative pricing approaches” for long-term service. The staff recommended that the cost of facilities “necessary to interconnect a new generating resource” to NU’s network facilities should be “borne by the entity requesting transmission service.”²⁸⁵

The presiding judge deferred decision of specific pricing for new construction because “[w]e are dealing with unknown costs of unknown facilities to be built at unknown times in unknown places for unknown reasons.”²⁸⁶ However, he rejected rolling in the cost of upgrades because “while administratively simple, [it] blends everything and everyone together, and thus ignores any concept of responsibility.”²⁸⁷ He asked “[w]hy should the New Hampshire Commission, for example, authorize an upgrade to benefit Massachusetts wheeling customers, if its costs are to be partly borne by New Hampshire ratepayers?”²⁸⁸ He found that the company’s test, that wheeling customers would make a pro rata contribution whenever new facilities would not have been needed “but for” the request wheeling, was “even-handed and neutral.”²⁸⁹

E. Market Definition: When Is Transmission a Market?

With all the attention given to transmission access in recent merger hearings, an interested observer could not be faulted for assuming that transmission is always a relevant product market. This has not, however, been the case, and there have been heated exchanges over whether a transmission “market” can properly be defined. The Commission found in *Utah Power & Light* that various transmission “corridors” constituted separate transmission “markets,”²⁹⁰ but subsequent parties have argued that this type of market definition is too narrow, and inappropriately excludes reasonable substitutes for transmission.

In *Southern California Edison*, various economists concluded that the transmission corridors linking Southern California with the Pacific Northwest and Desert Southwest were relevant markets. There were differing rationales, but one common theme was that the transmission corridors provided access to unique resources (hydropower and winter peaking utilities in the Northwest, and coal and nuclear power and summer peaking utilities in the Southwest), at lower economy energy costs than the incremental cost of local generation.²⁹¹

The applicants criticized this approach as failing to “take into account all reasonable substitutes.”²⁹² The economists for the company testified that the

284. Ex. 601 at 32, No. EC90-10-000 (F.E.R.C.). The staff witness reasoned that “Specific portions of network transmission facilities are not generally assigned to specific customers or users.” *Id.*

285. *Id.* at 32, 35.

286. Northeast Utils. Serv. Co., 53 F.E.R.C. ¶ 63,020, at 65,223 (1990) (decision of administrative law judge).

287. *Id.* at 65,222.

288. *Id.*

289. *Id.* at 65,223.

290. Utah Power & Light Co., 45 F.E.R.C. ¶ 61,095, at 61,285 (1988).

291. Post-Hearing Reply Brief of City of San Diego at 22-23, No. EC89-5-000 (F.E.R.C.).

292. Post-Hearing Brief of Applicants at 70, No. EC89-5-000 (F.E.R.C.).

appropriate treatment of such transmission paths would be to include them in a larger delivered bulk power "destination market." This market would measure all the alternatives to a utility or group of utilities in a particular destination, including local generation and available transmission capacity on lines serving that area.²⁹³

If transmission were to constitute a market, should it be limited to *excess* transmission capacity (not committed to contract or native load)?²⁹⁴ The issue has become so important that the FERC staff in *Southern California Edison* listed it as one of the key policy considerations warranting Commission review of the judge's decision.²⁹⁵ The Commission in its *Kansas City Power & Light* hearing order indicated its interest in this argument, when it requested evidence on "the extent of unused, uncommitted or divertible transmission capacity and its impact on the competitive situation."²⁹⁶

In *Southern California Edison*, most intervenor economists opted to include all transmission entitlements in the market, with one concluding that this would approximate the relative shares of "nondedicated" capacity.²⁹⁷ Some referred to the Merger Guidelines statement that "[c]aptive production and consumption of the relevant product by vertically integrated firms are part of the overall market supply and demand."²⁹⁸

The economists for the applicants disagreed, concluding that transmission dedicated to native load or contract could not be freed up to respond to a price increase, and even if a firm did so, it would incur a penalty by forfeiting the value of the generation it was supposed to transport.²⁹⁹ The applicants relied on a different provision of the Merger Guidelines, which states that in "some cases . . . total sales or capacity may overstate the competitive significance of a firm," such as where "a firm's capacity may be so committed elsewhere that it would not be available to respond to an increase in price in the market."³⁰⁰

The judge in *Southern California Edison* sided with the intervenors. He found that transmission was a relevant market, and that the merger increased

293. *Id.* at 70. In *Buckeye Pipe Line Co.*, a oil pipeline case, the Commission held that "[b]ecause shippers or customers in the destination market often have the option of switching away from purchasing the delivered product itself, suppliers of transportation must compete with suppliers of the delivered product." Opinion No. 360, *Buckeye Pipe Line Co.*, 53 F.E.R.C. ¶ 61,473, at 62,666 (1990).

294. "If the definition of a firm power market includes only wholesale sales, is the share of total generating capacity a relevant market power measure? Under what conditions should capacity dedicated to retail sales be included?" *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097, at 61,287 (1990).

295. Staff Brief on Exceptions at 2, No. EC89-5-000 (F.E.R.C. Dec. 27, 1990).

296. *Kansas City*, 53 F.E.R.C. ¶ 61,097, at 61,288.

297. Post-Hearing Br. of City of San Diego at 66, No. EC89-5-000 (F.E.R.C.) (citing testimony of Dr. Owen).

298. Merger Guidelines, *supra* note 43, § 2.23, at 26,829. The Department's rationale is that such firms can respond to a price increase by (1) selling some of the product previously devoted to internal consumption, or (2) increasing production of the product. *Id.*

299. Post-Hearing Brief of Applicants at 67, No. 89-5-000 (F.E.R.C.).

300. Merger Guidelines, *supra* note 43, § 2.4, at 26,830. In *General Dynamics*, the Supreme Court found that the company's total coal reserves was not the relevant measure of its market share, for much of the coal "is typically already committed under a long-term supply contract." *United States v. General Dynamics Corp.*, 415 U.S. 486, 501-02 (1974).

Edison's control over certain valuable transmission corridors. He found the "paucity of alternative transmission services correlates to the concentration of market power in the surviving corporation."³⁰¹ He did not comment specifically on the excess vs. total capacity market definition issue.

These debates arose again in *Northeast Utilities*. There, a critical concern was the ability of NU and PSNH to exert market power over certain utilities located in Eastern Massachusetts and Rhode Island (known as "Eastern REMVEC"). If the market were defined as the ownership of transmission lines linking these utilities with other power sources within New England, NU and PSNH would control approximately 80% of the "market."³⁰² This was because the service territories of PSNH and NU bordered the territories of the Eastern REMVEC utilities. If, however, one were to look at Eastern REMVEC as a destination market, and combine local generation options with available (not total) transmission capacity that NU and PSNH (or other utilities) could use to transmit power into Eastern REMVEC, an entirely different answer emerged. In this market, NU and PSNH controlled approximately 20% of the available options into Eastern REMVEC.³⁰³ The treatment of NU and PSNH transmission—either a "curtain" surrounding Eastern REMVEC, or only one of many options—was determinative.³⁰⁴

The judge opted for the transmission "curtain" approach, although he did not plunge into the intricacies of market definition. He found "abundant evidence that the merged company will have 'market power' by controlling the New England transmission 'curtain'."³⁰⁵ He found that the merged company would control 92% of the transmission "capacity available for New England," leaving "45 Eastern REMVEC utilities 'isolated' inside the curtain."³⁰⁶ On the issue of other, intra-Eastern REMVEC resources (NUGs, etc.), he found them to take too much time and to be too uncertain to be a competitive discipline.³⁰⁷

F. *Transmission Dependent Utilities: Does It Help or Hurt To Be One?*

The issues of transmission access, priority, and pricing are vitally important to entities commonly referred to as TDUs, transmission dependent utilities. These entities are typically municipalities or other public entities

301. Southern Cal. Edison Co., 53 F.E.R.C. ¶ 63,014, at 65,105 (1990).

302. Ex. 372, No. EC90-10-000 (F.E.R.C.).

303. Ex. 55, No. EC90-10-000 (F.E.R.C.).

304. The issue of transmission markets was addressed by the FERC staff economists in both cases, but with differing results. In *Southern California Edison*, the staff economist found there to be a market for transmission services, both on Edison's local service territory transmission network, and on Edison's import transmission system stretching to the Pacific Northwest and Desert Southwest. Ex. 809, No. EC89-5-000 (F.E.R.C.). On measuring shares of transmission, this economist noted that "dedicated transmission capacity is not in the transmission market." Ex. 809 at 66, No. EC89-5-000 (F.E.R.C.). In *Northeast Utilities*, however, the staff economist identified a delivered bulk power market only, stating "[t]ransmission is not valued in and of itself. Its value derives entirely from the market for delivered bulk power products." Ex. 549, No. EC90-10-000 (F.E.R.C.).

305. Northeast Utils. Serv. Co., 53 F.E.R.C. ¶ 63,020 at 65,219 (1990) (initial decision).

306. *Id.* at 65,215.

307. *Id.* at 65,215-17.

surrounded by the service territory of one of the merging utilities, and thus in need of transmission access.

In *Utah Power & Light*, the Commission set aside a specified portion of existing PacifiCorp transmission for existing TDU's.³⁰⁸ The Commission explained that this "preferential" allocation was the result of a finding that "certain defined entities had been competitively disadvantaged in the past" and thus were in need of a "short-term remedy."³⁰⁹ The Commission ordered that rates for these TDUs would be embedded cost for the first five years.³¹⁰ The Commission also made special provision for participation by TDUs in upgrades or improvements to PacifiCorp's transmission system.³¹¹

In *Southern California Edison*, staff proposed conditions designed to provide certain municipal TDUs with "open access to the bulk power market at cost-based rates."³¹² This special treatment of TDUs was justified on the basis of the finding that "[n]o viable alternatives exist to the Edison system" for TDUs, and that "[o]ther utility systems lack this same economic and technical dependency."³¹³ The affected cities generally supported staff's approach.

Edison disagreed, arguing that regardless of the "dependency" of these cities on Edison, the "fundamental difficulty" with the staff's approach was that the merger had "no effect" on Edison's service territory transmission network, the system surrounding TDUs.³¹⁴ Edison took exception to the staff's contention that SDG&E could be considered a "potential entrant" for service to the cities, which would be eliminated by the merger. Edison argued that "at best" SDG&E could be considered a provider of only "limited amounts" of transmission service to the TDUs, and further that SDG&E could not "directly" connect with certain of the cities and has "neither the intent nor the means" to expand its service to the TDUs.³¹⁵ The judge did not address these arguments.

In *Northeast Utilities*, certain TDUs sought transmission access equal to that of NU's native load customers. The judge recognized that such entities were "small companies, uniquely vulnerable to possible anti-competitive conduct" and were entitled to "some measure of protective assurance regarding NU/PSNH's post merger conduct."³¹⁶ The judge, however, rejected the proposed conditions, finding it "would give the TDU's a higher status than they had before the merger" and "there is no reason why the merger should be the

308. Opinion No. 318, *Utah Power & Light Co.*, 45 F.E.R.C. ¶ 61,095, at 61,291 (1988). The Commission limited participation in this category to dependent municipalities existing at the time of the merger because it "was these entities . . . who suffered the harm from anticompetitive effects, and thus should be allowed to secure the remedy." Opinion 318-B, *Utah Power & Light Co.*, 48 F.E.R.C. ¶ 61,035, at 61,181 (1989).

309. *Utah*, 48 F.E.R.C. ¶ 61,035, at 61,182.

310. *Utah*, 45 F.E.R.C. ¶ 61,095, at 61,292.

311. *Id.* at 61,293.

312. Ex. 844 at 51, No. EC89-5-000 (F.E.R.C.).

313. *Id.* at 53.

314. Post-Hearing Original Brief of Applicants at 81, No. EC89-5-000 (F.E.R.C.).

315. *Id.* at 84-85.

316. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,233 (1990) (decision of administrative law judge).

occasion for such a transformation.”³¹⁷

G. Exercising Market Power: Is Potential Entry a Restraint?

Potential “entry” into a market is a critical issue in merger cases, especially those involving firms in an unregulated industry. If entry into a market by new or already existing firms is easy, then a monopolist’s attempt to raise prices to above-market levels will ultimately be unsuccessful. It is so important that the FTC has held that “in the absence of barriers or impediments to entry, an acquisition cannot have anticompetitive effects, and therefore, cannot violate Section 7 of the Clayton Act.”³¹⁸

In the electric utility industry, entry is affected by regulatory forces, production costs and time lags.³¹⁹ In the wholesale bulk power market, the most likely “entry” may be by independent power generators, namely QFs and IPPs.³²⁰ Were a monopolist or oligopolists to seek to raise the price of wholesale power, or were merely inefficient in producing it, these firms could theoretically respond by supplying lower cost power, assuming available transmission to deliver the power. The critical questions would be how quickly this entry could occur, and if it did, then how much of a constraining force would it be?³²¹

The issue was developed in great detail in *Northeast Utilities*. As the Commission noted in its hearing order, “the New England region has moved further toward competitive procurement than perhaps any other region,” with competitive solicitations involving “new participants in the bulk power markets.”³²² There was general agreement by the economists and planners that generation resources could take from two to five years (or longer) to be brought on line for actual production.³²³ The experts diverged, however, on how such lead times should be considered.

The FERC staff economist concluded that resources with such a long

317. *Id.*

318. B.F. Goodrich Co., 5 Trade Reg. Rep. (CCH) ¶ 22,519, at 22,142 (1988).

319. There are long lead times for constructing both transmission and new generation. See FERC TRANSMISSION TASK FORCE, *supra* note 10, at 39-44. Moreover, “[r]egulation has typically restricted entry, impeded price competition and regulated conditions of service without seeking to maximize competition.” Hughes & Hall, *supra* note 28, at 247.

320. In *Kansas City Power & Light Co.*, the FERC requested evidence on “the issue of potential entry into the relevant generation markets and its importance in assessing the merged company’s market power, if any.” *Kansas City Power & Light Co.*, 53 F.E.R.C. ¶ 61,097, at 61,287 (1990).

321. See Whalley, *supra* note 67, at 111:

First, [the Justice Department’s] focus is on the time required for entry: how long will it take for effective entry to occur? Second, it must be effective entry, i.e., the entry of a competitor or competitors at a level and in such a way that the new competition can affect pricing.

322. *Northeast Utils. Serv. Co.*, 50 F.E.R.C. ¶ 61,266, at 61,835 n.46 (1990). The Commission in its hearing order asked the parties to address “To what extent can the combined company’s transmission system be used to prevent competitive entry of new generation facilities or to exclude potential competitors (whether existing or new) from delivered bulk power markets.” *Id.* at 61,835.

323. According to the GAO, obtaining approvals and constructing a generating plant may take “up to five years or more.” UNITED STATES GENERAL ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, COMMITTEE ON ENERGY AND COMMERCE, HOUSE OF REPRESENTATIVES: ELECTRICITY SUPPLY 3 (Aug. 1990) (GAO/RCED-90-182).

lead time should not be included in the "market," relying on the Merger Guidelines statement that "a two-year time period generally will be used" in evaluating whether a potential entrant should be assigned a market share.³²⁴ The staff also argued that nonutility generation may be unduly speculative, facing numerous siting and financing hurdles.

The economist for NU took exception to this view. He argued that since utilities contract well in advance for their long-term needs, the inquiry should focus on whether nonutility generators and other resources can compete with utility generation at the time a utility considers generation acquisitions.³²⁵ In simple terms, these resources essentially "enter" the market when they win a competitive bid, not when actually constructed.

The judge came down with the intervenors. Though he did not stumble around with market definition principles, he found that "although NUGs will certainly operate, the magnitude and likelihood of their full projected availability is not such to support them as remedies for the merger's anti-competitive potential" or to "neutralize the merged company's strength."³²⁶ This was principally based on the conclusion that NUGs are subject to "many uncertainties" and have long lead times in being constructed.³²⁷

In *Public Service Co. of Indiana*, the Commission made several comments on market entry. It observed that "[t]he long lead time for a decision to build or to buy helps make the current distribution of excess generation less important than the absence of barriers to trade and to new entry into the market."³²⁸ It also stated that "the lack of significant barriers to the entry of new generation" was "more important" than various projections of market share.³²⁹ Finally, it concluded that "there is mounting evidence that attempts by a utility such as PSI to exercise market power by raising price will bring forth new generation supplies."³³⁰

If entry into the generation business is deemed feasible, then the question becomes whether the entrant can effectively compete to make a sale given transmission control and constraints.³³¹ The Commission in *PSI* recognized this dimension of the issue, stating "the ability of PSI's potential customers

324. Merger Guidelines, *supra* note 43, § 3.3, at 26,832. See *Echlin Manufacturing Co.*, 105 F.T.C. 410, 487 (1985) ("if entry into an industry is only possible by constructing a physical plant that cannot be completed in less than a decade, that industry would appear to be characterized by a high barrier to entry for purposes of an analysis under Section 7").

325. See *JOSKOW & SCHMALENSEE*, *supra* note 14, at 192 ("the process of competitive entry would not involve the sudden appearance of new capacity that one sometimes sees in other sectors and that is generally assumed in theoretical analysis").

326. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,216 (1990).

327. *Id.*

328. Opinion No. 349, *Public Serv. Co. of Ind.*, 51 F.E.R.C. ¶ 61,367, at 62,208 (1990).

Self-generation additions to utility capacity, and nonutility generation are available in the long term. The overall response to date to utility requests for proposals (RFPs) is a strong indication that such additions will be available in sufficient amounts, in a time period well within the normal planning horizon for long-term firm power supplies.

Id.

329. *Id.*

330. *Id.*

331. In *Northeast Utilities*, this was an important issue. Many intervenor economists testified that most

under the [PSI sales] program to reach alternative sources of supply" is critical in assessing whether PSI had market power.

H. Divestiture: Should It Be Considered as a Remedy?

Ordering a company to divest itself of certain divisions or assets is a common remedy for a violation of section 7 of the Clayton Act. Divestiture as a form of relief is so accepted that the Supreme Court, just last Term, confidently stated, "divestiture is the preferred remedy for an illegal merger or acquisition."³³² Citing a previous decision, the Court referred to divestiture as "the most important of antitrust remedies" because it "is simple, relatively easy to administer, and sure."³³³ Is it a remedy the Commission should consider for electric utility mergers?³³⁴

In *Southern California Edison*, the issue arose in connection with Edison's ownership of Mission Energy, its QF subsidiary. An economist testifying for the City of San Diego charged that the vertical integration of Mission Energy and capacity-needy SDG&E would be anticompetitive and that "[o]nly divestiture by the merged entity of all its interests in generation would eliminate the competitive problems."³³⁵ The judge did not specifically address the divestiture option.

The issue also came up in *Northeast Utilities*. One of the TDUs in *Northeast Utilities* proposed divestiture of NU transmission and generation assets as a remedy. The judge described divestiture as a "drastic remedy" and a "serious and difficult step."³³⁶ He found the Commission had adequate ability to police NU's wheeling practices without such measures.

On a separate matter, one of the principal concerns raised by the FERC staff and intervenors was that NU's acquisition of the PSNH transmission system, combined with the NU system, would give it effective control over bulk power supplies available to utilities in Eastern Massachusetts and Rhode Island ("Eastern REMVEC"). To address such concerns, NU included in its direct case an offer to sell a substantial portion of existing capacity on PSNH's transmission system to Eastern REMVEC utilities on a long-term basis (10 to 30 years). NU argued that this offer to relinquish control through the sale of

new nonutility generation would be cited in Vermont, Maine and New Brunswick, and thus would require use of the NU/PSNH transmission system to reach load centers in and around Boston.

332. *California v. American Stores Co.*, 110 S. Ct. 1853, 1858-59 (1990). Similarly, Areeda & Turner state that "divestiture is the normal and usual remedy against an unlawful merger, whether sued by the government or by a private plaintiff." P. AREEDA & D. TURNER, *supra* note 39, ¶ 328b, at 137.

333. *American Stores*, 110 S. Ct. at 1859 (quoting *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 329-30 (1961)). The Court in *American Stores*, resolving a split in the circuits, held that divestiture is a remedy available to a private litigant under section 16 of the Clayton Act. For a sample of the commentary on divestiture, see Oppenheim, *Divestiture as a Remedy Under the Federal Antitrust Laws*, 19 GEO. WASH. L. REV. 119 (1950); Adams, *Dissolution, Divorcement, Divestiture: The Pyrrhic Victories of Antitrust*, 27 IND. L.J. 1 (1951); Note, *Divestiture as a Remedy in Private Actions Brought under Section 16 of the Clayton Act*, 84 MICH. L. REV. 1579 (1986).

334. For a discussion of certain recent, notable divestitures obtained by the FTC or Department of Justice, including those agreed to by Arkla Inc. and Panhandle Eastern Corp., see Axinn, *supra* note 37, at 409-411.

335. *Southern Cal. Edison Co.*, Ex. 710 at 190, No. EC89-5-000 (F.E.R.C.).

336. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,232 (1990) (initial decision).

entitlements should be “considered in the first instance in determining the effect of the merger on competition.”³³⁷ If such capacity were considered “divested,” it would substantially reduce the merging companies’ share of the market, however defined, post-merger. The judge described NU’s offer as an agreement to “lease” the facilities to other New England utilities, and found it beneficial, but did not evaluate it from a market definition or market share perspective.³³⁸

I. The Issue of Collusion: Do the Department of Justice Guidelines Provide Helpful Guidance in the Regulated Utility Setting?

Apart from the situation of where a “dominant” firm can act unilaterally as monopolist,³³⁹ the Merger Guidelines analysis of horizontal (and to some degree non-horizontal) mergers focuses on a concern over the ability of firms in a particular market to “collude” in setting prices above the competitive level. Collusion is most likely to occur, according to the Department, “[w]here only a few firms account for most of the sales of a product.”³⁴⁰ In such cases, these firms may “either explicitly or implicitly coordinate their actions in order to approximate the performance of a monopolist.”³⁴¹ The HHI, a measure of market concentration, is designed to provide a numerical guide to assessing the likelihood that a merger may increase the possibility of collusion.

Is collusion a concern in the electric utility industry?³⁴² The ALJ in *Southern California Edison* suggested that it might be. The judge remarked that a larger Edison would, post-merger, “rival” PacifiCorp’s “sphere of influence,” and that these two firms would hold “market power” over transactions

337. Post-Hearing Brief of NU at 12, No. EC90-10-000 (F.E.R.C.).

338. In a somewhat analogous situation, the Commission in *PSI* considered the effect on concentration of PSI’s proposed sale of generation. It found “PSI can be considered to be a new entrant that effectively expands the size of the geographic market when viewed from the perspective of any single buyer.” As a result, “[a]ll traditional measures of market concentration used as indicators of market power, such as market share or HHIs, are improved by PSI’s proposal.” Opinion No. 349, Public Serv. Co. of Ind., 51 F.E.R.C. ¶ 61,367, at 62,207 n.45 (1990).

339. The Department may challenge a merger if a single “dominant” firm acquires a smaller firm, and the size of this dominant firm gives it the ability, unilaterally, to act as monopolist and impose price increases on consumers. In this case, collusion may not be relevant “because the ease and profitability of collusion are of little relevance to the ability of a single dominant firm to exercise market power.” Merger Guidelines, *supra* note 43, § 3.12, at 26,831. The Merger Guidelines state that such a firm should have a market share of “at least 35 percent.” *Id.*

340. *Id.* § 1, at 26,827.

341. *Id.*

342. The FERC’s Task Force mentioned the possibility of collusion in its report, but did not discuss it in any length. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 111. Joskow and Schmalensee acknowledge the “danger that efficiency-enhancing cooperation through [a power] pool or other coordinating entity will facilitate efficiency-reducing collusive behavior.” JOSKOW & SCHMALENSEE, *supra* note 14, at 194. Elsewhere, the authors refer to “a deep and unavoidable tension at several levels in the system between the need for cooperative actions and the undesirability of collusion.” *Id.* at 198. Other authors have considered the possibility for collusion among IPPs submitting bids, and found that “[w]ith sealed bids, competitors are ignorant of one another’s offers and would have great difficulty accomplishing explicit collusion.” Hughes & Hall, *supra* note 28, at 257.

in the WSCC.³⁴³ The judge feared that “[t]hese two utility giants, Pacificorp and the instant surviving corporation, would have the unconditional potential to profitably manipulate rates and foreclose access to electricity throughout the WSCC.”³⁴⁴

The issue of collusion was hotly contested in *Northeast Utilities*. Intervening utilities and the staff argued that the merger would reduce the number of competitors serving Eastern Massachusetts and Rhode Island and enhance the potential for collusion. NU disagreed, arguing that collusion is unlikely where each utility both buys and sells power to each other over the long term. Professor Hay of Cornell, testifying in support of NU, argued that the collusion scenario in such a circumstance presupposed that “utilities in New England will gang up to overcharge themselves.”³⁴⁵

The judge threw cold water on the collusion theory. He found likelihood of collusion between NU/PSNH and other utilities “virtually non-existent.” He relied on testimony by several Eastern REMVEC utility officials, hostile to the merger, that such behavior was “‘inconsistent with any behavior they had even heard of and inherently unthinkable.’”³⁴⁶

In *Buckeye Pipe Line Co.*, an oil pipeline case, the Commission found that “opportunities for collusion are insignificant and have no relevance in this case.”³⁴⁷ The Commission, however, differentiated between collusion and “interdependent pricing,” which may occur in a concentrated market where the “firms are likely to weigh the market ramifications of pricing decisions and likely actions of rivals before changing their prices.”³⁴⁸ The FERC held that it “does consider and weigh factors that might affect cooperative behavior in markets where the HHI indicates that such behavior may be of concern.”³⁴⁹

J. Concurrent State/Federal Jurisdiction over Utility Mergers: Will the Relationship Be Tension-Free?

The title to this section assumes something quite unusual in the field of electric utility regulation—concurrent state and federal authority.³⁵⁰ Most regulation in the electric field is separated by the “bright line” established in *Attleboro*,³⁵¹ and later codified in the Federal Power Act. This jurisdictional allocation gives states exclusive jurisdiction over retail power sales and transmission and generation siting, and the FERC exclusive jurisdiction over wholesale power sales and the transmission of energy in interstate

343. *Southern Cal. Edison Co.*, 53 F.E.R.C. ¶ 63,014, at 65,106 (1990).

344. *Id.*

345. Ex. 195 at 16, No. EC90-10-000 (F.E.R.C.). The parties also debated whether FERC or state regulation can act as a check on the potentiality of collusion.

346. *Northeast Utils. Serv. Co.*, 53 F.E.R.C. ¶ 63,020, at 65,219 (1990) (quoting Brief for Northeast Utilities Service Co. at 21-22).

347. Opinion No. 360, *Buckeye Pipe Line Co.*, 53 F.E.R.C. ¶ 61,473, at 62,668 (1990).

348. *Id.*

349. *Id.* at 62,669.

350. “The FPA . . . does not provide a mechanism for allocating state/federal jurisdictional authority or resolving disputes [relating to mergers.] Hence, each affected jurisdiction has an effective veto power over a proposed merger or acquisition.” Stalon & Lock, *supra* note 22, at 469-70.

351. *Public Utils. Comm’n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

commerce.³⁵²

The bright line has been buffeted in recent years with intense litigation over federal-state jurisdictional disputes.³⁵³ The author is not, however, aware of any successful challenge to a state's concurrent authority to approve a merger of one of its electric utilities.³⁵⁴ In the only apparent reported case addressing the issue, *Northern Pennsylvania Power Co. v. Pennsylvania Public Utility Commission*,³⁵⁵ a Pennsylvania district judge rejected the company's arguments that Congress intended section 203 to provide exclusive jurisdiction over mergers to the FPC (now FERC). The judge found that mergers involve a "dual interest," whereby the FERC would consider whether the merger harmed the "general [FPA] plan for the interconnection and coordination of facilities" and the state would consider whether it "will not prove injurious to the interests of the local consumer."³⁵⁶ The judge noted that states historically had the authority to approve mergers or consolidations of public utilities, and that section 201 of the FPA expressly provides that federal regulation was limited to "those matters which are not subject to regulation by the states."³⁵⁷

Though concurrent jurisdiction may be a happy result at present, state-federal tensions may soon erupt in merger proceedings.³⁵⁸ A prelude to such conflicts is *Northeast Utilities*, where the six New England states had conflicting interests on most issues. Utilities in Massachusetts, Rhode Island, Maine and Vermont advocated several conditions that would have affected ratepayers in New Hampshire and Connecticut (where NU and PSNH primarily operate). The State of New Hampshire objected to the conditions, and warned that certain conditions (such as the elimination of native load priority³⁵⁹) were unacceptable, and would be considered "deal breakers." The State testified

352. See generally Vince & Moot, *Federal Preemption Versus State Utility Regulation in a Post-Mississippi Era*, 10 ENERGY L.J. 1, 9-16 (1989).

353. See generally *id.* at 25-63; Vince & Moot, *Energy Federalism, Choice of Forum, and State Utility Regulation*, 42 ADMIN. L. REV. 323 (1990); Stalon & Lock, *supra* note 22.

354. The Commission on rehearing in *Utah Power & Light* acknowledged that one state had suspended its approval of the merger "in light of [wheeling] conditions imposed by this Commission" but noted that the state had subsequently reinstated its approval of the merger. Opinion No. 318-A, *Utah Power & Light Co.*, 47 F.E.R.C. ¶ 61,209, at 61,722 n.3 (1989). "Despite major concerns by the Utah PUC that the FERC-imposed conditions would damage the interests of Utah's ratepayers, the company was able to persuade all the PUCs that the benefits of the merger would outweigh any detriments caused by FERC's conditions." Stalon & Lock, *supra* note 22, at 470.

355. 200 A. 866, 132 Pa. Super. 178 (1938), *rev'd on other grounds*, 5 A.2d 133, 333 Pa. 265 (1939).

356. *Northern*, 200 A. 866, at 875.

357. 16 U.S.C. § 824(a) (1988).

358. The FERC's Task Force on transmission made no bones about its worry that states could act with "parochial" interests in limiting the construction of transmission for interstate purposes, and act essentially as "monopolists" for the benefit of local retail ratepayers. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 185-87. See also Stalon & Lock, *supra* note 22, at 470 (noting "the potential for conflict between FERC's regulatory objective of enhancing the efficiency of the wholesale bulk power markets and the more parochial objectives of state PUCs in protecting the interests of retail ratepayers"). For a discussion of the division of authority over transmission, see Brown, *The Balkans Revisited: A Modest Plan for Transmission Reform*, ELECTRICITY J., Apr. 1989, at 32.

359. The other two deal breakers were the loss of "single system status" within NEPOOL (which provided many of the benefits enabling New Hampshire to approve the deal), and the loss of voting power within NEPOOL.

that if such conditions were adopted by the FERC, the state, subsequently, likely would disapprove the merger.³⁶⁰ The judge, for the most part, avoided adopting such "deal-breaking" conditions, and thus declined to discuss the issue.

K. The Role of Regulation: Is It a Constraint on Market Power?

Perhaps the most fitting way to conclude this article is with a discussion of the role of regulation itself. The issue has taken on several dimensions in merger proceedings, all equally vexing.

One critical issue is the efficacy of transmission access regulation. The access problem has two dimensions: a transmission monopolist may either (1) withhold transmission service entirely, or (2) provide it at above-market prices. Regulation's ability to police the first problem is limited.³⁶¹ It has been argued that the FERC has limited authority to order wheeling in many instances.³⁶²

The second problem, that of monopoly pricing, is more complex. If the transmission rates are ultimately approved by the FERC, then how could they be anything other than just and reasonable? Economists have given several answers to this. One scenario occurs where the transmission owner with market power negotiates a contract prohibiting the transmission customer from challenging the rate or terms at the FERC. This can short-circuit a potential complaint as to pricing. Another problem involves the complex determinations involved in finding a "just and reasonable" rate. As Joskow and Schmalensee explain, "determination of optimal wheeling rates is extremely complex, and the opportunities for opportunistic behavior by the owner of a transmission system are numerous. It is thus not apparent that ordinary regulatory systems can effectively enforce obligations to provide access at reasonable terms."³⁶³

The Commission seemed to acknowledge these possibilities in *Utah Power & Light*. The Commission found that UP&L, by using its transmission bottleneck to engage in buy/sell transactions, "is able to charge a price that reflects more than the cost of the transmission service it provides."³⁶⁴ The administrative law judge in *Southern California Edison* made similar findings that Edison, along with PacifiCorp, would have the power "to profitably manipulate rates."³⁶⁵

Another difficult issue involves the unregulated affiliate. The danger is

360. "When transactions cross state borders . . . , the competing interests of the states, their ratepayers and their citizens become major issues." Hawes, *supra* note 9, at 14.

361. The FERC's Task Force on transmission postulated that "[u]tilities are not likely to deny access outright because of possible antitrust risk," but stated that they could do so "indirectly" through protracted negotiations, claims of unavailable capacity, and other means. FERC TRANSMISSION TASK FORCE, *supra* note 10, at 85.

362. Wallace, *supra* note 12, at 101-111. *But see* Associated Gas Distribs. v. FERC, 824 F.2d 981, 998-1000 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

363. JOSKOW & SCHMALENSEE, *supra* note 14, at 195.

364. Opinion No. 318, Utah Power & Light Co., 45 F.E.R.C. ¶ 61,095, at 61,288 (1988).

365. Southern Cal. Edison Co., 53 F.E.R.C. ¶ 63,014, at 65,106 (1990).

that an affiliate could overcharge its utility sibling for power, with the parent corporation pocketing the profit.

As indicated in earlier sections, in *Southern California Edison*, Edison was accused of preferential self-dealing with its QF subsidiary, Mission Energy. The Department of Justice jumped into the fray, expressing its concern over the "risk that Mission Energy may overcharge [the merged company] for power in order to capture supra-normal profits outside the rate-of-return umbrella."³⁶⁶ The Department subsequently settled with Edison on a provision prohibiting the merged company from "enter[ing] into any contract to purchase electricity from an affiliate . . . without the prior approval of the CPUC."³⁶⁷ The judge rejected this condition, finding that the FERC had no authority to impose it on the CPUC, and that "we are unaware of whether the CPUC would be willing to accept and effectively implement" it.³⁶⁸ The judge also criticized the FERC staff's suggestion that the CPUC could provide adequate remedies if abuses were found, calling this a "preference for emetic therapy rather than immunotherapy, i.e., disgorgement rather than prevention."³⁶⁹ He argued that although the CPUC could later find self-dealing to be imprudent, "refunds are a comparatively poor court of last resort."³⁷⁰ The judge was careful not to question the "competence of regulators," but declined all remedial options, relying on the conclusion that "there are inherent difficulties in the CPUC's monitoring the range of potential power supply options."³⁷¹

The Commission has recognized the potential for self-dealing with affiliated IPPs (non-PURPA entities). In *Portland General Exchange, Inc.*, the Commission commented that "sales to marketing affiliates . . . have the potential for preferential dealing."³⁷² The incentive would be for the utility to underprice the sale to its marketing affiliate, which could then pocket a markup from a resale to a wholesale customer.³⁷³ In this situation, the profit would accrue to the common shareholder of the utility and its affiliate, whereas profits from an ordinary off-system sale would likely be flowed through to native load ratepayers.

To close out the article, the ultimate question perhaps is: to condition or not condition? If a merger may substantially lessen competition, should the FERC reject it entirely or fashion conditions to remedy the anticompetitive effects?³⁷⁴ The FERC can choose from alternative approaches, either (a) a regulatory oversight model, where transmission access and other conditions are imposed, perhaps requiring continuing Commission involvement in the

366. *Id.* at 65,110 (citing Department of Justice Post-Hearing Brief at 2).

367. *Id.* at 65,146.

368. *Id.*

369. *Id.* at 65,114.

370. *Id.* The judge noted that six full years after the investigation into one instance of alleged self-dealing, the ratepayers had not "seen a kopeck of the overcharges returned to them." *Id.*

371. *Edison*, 53 F.E.R.C. ¶ 63,014, at 65,112.

372. *Portland Gen. Exch., Inc.*, 51 F.E.R.C. ¶ 61,108, at 61,244-45 (1990).

373. *Id.* at 61,245.

374. The Commission has "asserted authority to turn an anticompetitive merger into a combination which is consistent with the public interest." *Williams*, *supra* note 15, at 27.

affairs of the merged company; or (b) a judicial model, where the Commission would deny an anticompetitive merger outright, or adopt a one-time solution such as divestiture.

The judge in *Southern California Edison* was of the opinion that it should be the latter. He argued that as a "practical matter" the Commission does not have the power to condition the "dynamics" of the marketplace so as to transform a noncompetitive market into a competitive market.³⁷⁵ Moreover, as a general matter, he was of the opinion that "[c]onditions attached to merger authorizations increase regulatory intervention in the marketplace and result in greater costs to society," whereas the rejection of a merger "allows greater reliance on market forces."³⁷⁶ This will perhaps be the most difficult, and most important, call for the Commission as it reviews the ALJ decision.

VI. CONCLUSION

Was this a tedious journey through merger minutia? Or are there truly unresolved issues of genuine importance to the industry and its appointed regulators? There is certainly fodder for either view, but it seems fair to say that the FERC has a substantial task confronting it in the coming years. There will be more and more utility mergers, in all shapes and sizes, and if the FERC is serious about reducing the burdens of regulation and streamlining the regulatory process, it will step up to the bar with some answers. The FERC could issue "guidelines," as the Department of Justice and Federal Trade Commission have done. It could issue "precedential" merger opinions, perhaps even in the cases presently before it. In either event, it should avoid the temptation to confine each opinion so narrowly to its facts that, soon after issuance, it begins to collect dust on the shelves of law libraries. Understandably, this type of decisionmaking offers a comfortable and protective refuge and avoids the pitfalls of sweeping generalizations. But being so overly cautious may have serious implications as well. It would surely be sad to accept the thought that "the only sure winners under the FERC's . . . approach to big electric utility mergers are the members of the Federal Energy Bar."³⁷⁷ Certainly, more certainty would be appropriate.

375. *Edison*, 53 F.E.R.C. ¶ 63,014, at 65,147.

376. *Id.* at 65,148.

377. Williams, *supra* note 15, at 30. The author of the quotation intended it in jest.